

Honorable Mayor and City Council of the City of San Diego, California

The purpose of this report is to provide the Mayor and City Council with an update on the Fiscal Year 2004 Budget, with an emphasis on the General Fund, its current status and plans for being in balance at the end of the fiscal year under current circumstances and assumptions, and an overview of Fiscal Year 2005 budget issues. The report provides Fiscal Year 2004 year-end projections based on the availability of eight months of actual revenue and expenditure data, and is a status of City funds at that point in time. While it is anticipated that, as new data becomes available, some of these figures will change, this status update represents the available information to date and reflects the current status, barring unanticipated events that may require modifications. The report is also a preliminary outlook on the Fiscal Year 2005 Proposed Budget, including the projected status of revenues and expenditures and some of the fiscal issues that are being addressed. The financial information represents estimates that are subject to change. This report does not discuss long term funding solutions for the pension issue, which issues transcend the Fiscal Year 2005 Proposed Budget. This report presents the actions that may be taken to address projected shortfalls and solutions to ensure a balanced budget in Fiscal Year 2004, and proposals for a balanced budget in Fiscal Year 2005 only. The Fiscal Year 2005 Proposed Budget will be presented on May 3, 2004.

FISCAL YEAR 2004 STATUS

The City Council adopted a budget for Fiscal Year 2004 totaling \$2.3 billion including \$743.0 million for General Fund expenditures, \$758.6 million for Enterprise Fund operations, \$287.8 million for Special Revenue Fund operations, \$10.8 million for Debt Service and Tax Funds, and \$467.6 million for Capital Improvements Program expenditures, with an adjustment for interfund transactions of \$175.0 million. Of this \$2.3 billion budget, all funds are operating consistently within their anticipated budgets except the City's General Fund, which comprises approximately 32.8 percent of the City's total budget. Although the General Fund is experiencing financial challenges, the City Charter requires a balanced budget at year-end. In order to ensure a balanced General Fund, several solutions have been developed for Fiscal Year 2004. This report will focus on the General Fund challenges and solutions, along with their service-level impacts, and will review the status of major General Fund revenues. Appendix A provides a brief review of General Fund revenue sources other than major revenue sources. For updates on the status of other City funds, please refer to Appendices B, C and D, which cover Enterprise Funds, Special Revenue Funds and Internal Service Funds, respectively.

In Fiscal Year 2004, the General Fund faces two types of financial challenges: Increased operating requirements and external events. Section I - Status of General Fund Expenditures and Revenues for Fiscal Year 2004 describes the challenges in funding City operations within the context of services provided and additional dollars available through the major General Fund revenues. Section II - Cedar Fire and State Impact provides the latest detail on a) expenditures and reimbursements for costs associated with fighting last fall's fire and short term recovery efforts, and b) describes the loss of revenue due to action by the State of California in Fiscal Year 2004. The City's Fiscal Year 2004 budget adopted by the Mayor and City Council last year was balanced. The unanticipated fire event and state revenue degradation must therefore be accommodated through additional unbudgeted revenues and/or expenditure reductions. The chart below summarizes the estimated current fiscal position of the General Fund in Fiscal Year 2004.

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FISCAL YEAR 2004 GENERAL FUND ADDITIONAL ESTIMATED REQUIREMENTS

State Take Away (VLF)	\$ 13,886,896
Cedar Fire Expenditures	6,421,788
Expenditures in Excess of Estimates or Unbudgeted	<u>15,675,000</u>
TOTAL GENERAL FUND ADDITIONAL ESTIMATED REQUIREMENTS	\$ 35,983,684

FISCAL YEAR 2004 GENERAL FUND PROPOSED SOLUTIONS

Revenue in Excess of Estimates or Unbudgeted	\$ 12,800,000
Sales Tax Accrual	10,000,000
Non-Public Safety Department Reductions/Savings	10,722,000
FEMA/OES Fire Reimbursements (estimate)	3,054,176
Support for Fire Helicopter (donations)	<u>1,460,000</u>
TOTAL GENERAL FUND PROPOSED SOLUTIONS	\$ 38,036,176

NET FISCAL YEAR 2004 GENERAL FUND ESTIMATED SURPLUS	\$ 2,052,492
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The various requirements and solutions as summarized here are described in more detail below.

I. STATUS OF GENERAL FUND EXPENDITURES AND REVENUES FOR FISCAL YEAR 2004

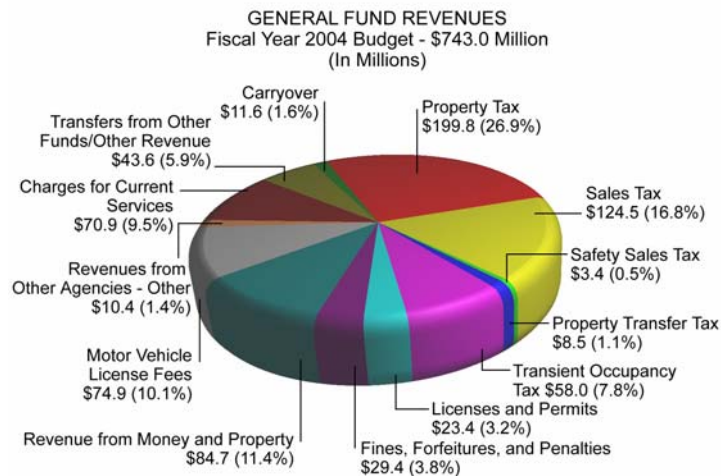
In recent years, the increased cost of providing services along with relatively slow economic growth, coupled with the state's diversion of City revenues, have restricted the City's ability to fund both ongoing and additional service needs in the General Fund. Revenue growth in the General Fund in Fiscal Years 1999-2001 was above seven percent, while revenue growth in Fiscal Year 2002 was approximately 3.5 percent and only 0.5 percent in Fiscal Year 2003. For Fiscal Year 2004, revenue growth is projected to be 0.9 percent, not counting the loss of additional revenues to the State of California as described in more detail in this report. The cumulative slow economic growth in Fiscal Years 2002 and 2003 has been fiscally challenging. In Fiscal Year 2004 economic growth has improved.

General Fund Revenues

In Fiscal Year 2004, the General Fund revenue budget was \$743 million. Five major revenue sources, property tax; sales tax; motor vehicle license fees (VLF); Transient Occupancy Tax (TOT); and franchise fees, account for 68.5 percent, or \$509 million, of the total General Fund revenue budget.

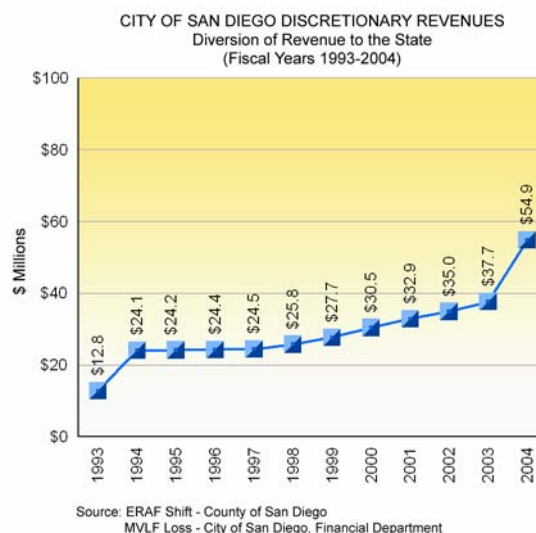
Based on revenue receipts through the first eight months of Fiscal Year 2004, the major revenues are projected to come in at \$505.3 million by year-end, which is below budget estimates. This deficit is primarily due to the loss of approximately \$13.9 million in VLF backfill revenue due to state action. Without this VLF revenue loss, the major revenues would be projecting a \$9-11 million surplus. Other General Fund revenues make up the balance of funds available in the budget. For more detail on the nature and status of these revenues, refer to Appendix A. In sum, these other General Fund revenues are projecting a surplus of approximately \$500,000 and \$1 million. Finally, the General Fund has realized an additional \$2.3 million in unbudgeted revenue due to the settlement of litigation relating to overcharging of the City in the Civic Center Plaza Building. It is projected that there will be an additional estimated \$12-13 million in revenue in excess of estimates.

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The major revenue sources are highly sensitive to economic conditions and, with the exception of Property Tax, have suffered to varying degrees throughout the past several years. The economy has struggled to recover from the recession in 2001, as a weak job market and reserved business spending have hindered a full recovery. In Fiscal Year 2004, however, state, local and national economic conditions have begun to show improvements, which are reflected in the current year receipts of the major revenues.

As will be shown, it is the diversion of City revenues by the State of California that is the major component in the reduction of the City's revenue base. While the economic growth of revenues this fiscal year has increased, loss of revenues to the state creates an inability to fund some operational needs in the City. As the following chart shows, the state is diverting approximately \$55 million in revenue in Fiscal Year 2004 alone. This includes impacts of over \$41 million from the permanent shift in Property Tax to the Educational Revenue Augmentation Fund in Fiscal Years 1993 and 1994, as described in detail in the Property Tax section below, and loss of almost \$14 million in Motor Vehicle License Fee revenue in Fiscal Year 2004, which is detailed in the State Impact section.



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Further state revenue shifts are proposed in future fiscal years, as well. Detail on Fiscal Year 2005 proposals is provided in the Fiscal Year 2005 Forecast-State Impact section.

A more detailed description and current year status of each major revenue source is provided below. The bar charts that follow reflect actual revenue data for Fiscal Years 2000-2003 and year-end projections for Fiscal Year 2004.

Property Tax

Property Tax revenue is collected by the County Tax Collector, and is based on a one percent levy on the assessed value of all real property. Proposition 13, passed by California voters in 1978, specifies that the Property Tax rate may not exceed one percent, and that assessed value may not exceed two percent growth per year unless there is a change in ownership or significant renovations.

The one percent Property Tax levy collected by the County Tax Collector is allocated to a number of agencies within the County's geographic area, including municipalities, school districts, special districts, and the County itself. For every \$100 that is collected in Property Tax, the City of San Diego's allocation amounts to \$16.90, which is a decrease from the previously allocated \$17.10 that the City received in prior years. This figure has changed over time based on refinements in the allocation or structural reductions in Property Tax allocations by the state.

Over the last decade, several factors have contributed to a structural reduction in the amount of revenue that the City has received from Property Tax. In Fiscal Year 1993 the state took action to reduce its General Fund obligation for school funding by shifting local Property Tax revenue to school districts via the Educational Revenue Augmentation Fund (ERAF). This reallocation of funds caused a permanent shift in Property Tax revenue that has resulted in a cumulative loss of almost \$341 million to the City of San Diego through Fiscal Year 2004, according to the County of San Diego. In addition to the ERAF shifts, in Fiscal Year 1991 the state authorized counties to charge cities administrative fees for collecting and distributing Property Tax revenue. These charges have amounted to a cumulative total of approximately \$14 million through Fiscal Year 2004.



In Fiscal Year 2004, Property Tax revenue was budgeted at \$199.8 million, an eight percent projected growth over Fiscal Year 2003 year-end estimates. Through the first half of Fiscal Year 2004, Property Tax is tracking

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on budget and projected to come in at \$200.0 million at year end. This figure reflects continued strength in the San Diego regional housing market, as mortgage rates remain low and demand for housing continues to outpace supply.

According to DataQuick, a local housing industry research company, the median price of an existing detached single-family home in San Diego County in February was \$442,000, an 18.7 percent increase over the median price in February 2003, and \$18,000 higher than in January 2004. The median price for all house and condo sales reached \$406,000 in February, up 23 percent from the previous year and topping the previous record of \$405,000 set in December 2003. On the statewide level, the California Association of Realtors reports that sales of existing detached single-family homes in calendar year 2003 have exceeded 2002's record setting pace of 572,500 units.

Sales Tax

Sales tax is the largest non-Property Tax source of revenue for the City's General Fund. The City receives one cent (or 13 percent) of the total Sales Tax levied on each dollar of taxable sales within the City of San Diego. The current Sales Tax rate in San Diego County is 7.75 percent, which consists of the statewide rate of 7.25 percent, plus 0.5 percent that is charged County-wide for transportation purposes (TransNet). Sales Tax revenue is collected at the point of sale and forwarded to the state Board of Equalization. The City's portion of the Sales Tax revenue is then remitted by the state in the form of monthly payments.

The Fiscal Year 2004 Sales Tax budget is \$191.6 million, \$124.6 million of which is budgeted to the General Fund. The total citywide Sales Tax budget for Fiscal Year 2004 represents a three percent projected growth over Fiscal Year 2003 year-end estimates. To date, Sales Tax revenue is projected to come in at \$197.5 million, more than 2 percent over the budget estimates and nearly 4 percent over Fiscal Year 2003 actual receipts.



Year-to-date receipts reflect continued improvement in the local economy. According to the state's Employment Development Department, total wage and salary employment in San Diego County averaged 1,418,300 in 2003, a 1.7 percent increase over the 2002 average. The County's unemployment rate fell to 3.9 percent in February, down from 4.1 percent in January and 4.4 percent in February 2003. Total wage and salary employment increased by 7,600 in February, giving San Diego the fourth lowest unemployment rate in the state behind only Marin, Orange and San Luis Obispo Counties. The drop in San Diego's unemployment rate came

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with an increase in the labor force, indicating that the region's labor market is poised to handle the growth in population.

Nationally, same-store retail sales, defined as sales at stores that have been open for at least one year, grew by 4 percent in December, making the 2003 holiday the strongest shopping season in four years, according to the Goldman Sachs index of same-store sales. Sales in January 2004 maintained the strong pace, growing 5.8 percent as consumers cashed in their holiday gift cards, according to the National Retail Sales Estimate of ShopperTrak, a Chicago retail-data firm. The Commerce Department reported that retail sales in February increased 0.6 percent from January, and 7.5 percent from February 2003, while the International Council of Shopping Centers reported that same-store sales increased 6.7 percent. Retail experts expect strong sales to continue throughout the first quarter of 2004, due to tax refunds and a relaxed political and social environment, according to the Wall Street Journal.

Business fixed investment, the primary engine behind the boom of the late 1990s and the main cause of the recession in 2001, is recovering solidly. The Commerce Department reported that business investment in equipment and software increased 15.1 percent in the fourth quarter of 2003, while third-quarter corporate profits increased 30 percent, the largest year-over-year change in three years.

Transient Occupancy Tax (TOT)

Transient Occupancy Tax (TOT) is levied on the daily rental price for rooms in hotels and motels used by visitors staying in San Diego for less than one month. Commonly known as the hotel tax or room tax, San Diego's TOT is levied at ten and one-half cents per dollar of the daily room price. Currently, an equivalent of five cents of the TOT, or approximately 48 percent, is allocated to Special Promotional Programs for the promotion of tourism and other purposes designated by City Council policy. The remaining five and one-half cents, or approximately 52 percent, is allocated directly to the General Fund for general government purposes. The TOT was last raised in August 1994, when the rate was increased by one and one-half cents per dollar.



In Fiscal Year 2004, total City TOT is budgeted at \$110.7 million, a 5.5 percent projected growth over Fiscal Year 2003 year-end estimates. Approximately \$58 million is budgeted for the City's General Fund. Currently, total City TOT revenues are projected to come in at \$110.4 million at year end, essentially on budget. These

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projections reflect a tourism and lodging market that continues to recover from the recession and terrorist attacks in 2001.

San Diego continues to be among the top travel destinations in the country. Smith Travel Research reported that in the months of July and August, San Diego County's hotel occupancy rate was 85 percent and 84 percent respectively, the highest marks among the top 25 metropolitan markets. Through December 2003, only the city of New York and the island of Oahu, Hawaii posted higher occupancy rates than San Diego. Several factors have contributed to San Diego's comparative advantage over other travel destinations. According to a joint report from the San Diego Convention and Visitors Bureau (ConVis) and the Center for Hospitality and Tourism Research at San Diego State University, approximately two-thirds of all visitors to San Diego County come from other parts of California and Arizona, making San Diego primarily a "drive-in" market, and hence less affected by the decline in airline travel. In addition, the report stated, travel patterns have shifted in the last few years to reflect a preference for shorter, closer-to-home types of vacations – a good match for San Diego's perception as "a little paradise, not too far away."

The main challenges facing San Diego's lodging industry have been the decline in business travel and the lack of pricing power. Business travel has declined over the past several years as corporations have cut back on spending, although increased business travel was evident in the third and fourth quarters of 2003. The prevalence of the Internet has cut into the pricing power of many tourist markets, as bargain hunters are only a "point and click" away from finding the best deals. As a result, room prices remain relatively flat even though demand is increasing. This is evidenced in San Diego County, where through the first half of Fiscal Year 2004 total room nights sold was up nearly 8.3 percent from the previous year but average daily room revenue was up just 0.2 percent.

Motor Vehicle License Fees (VLF)

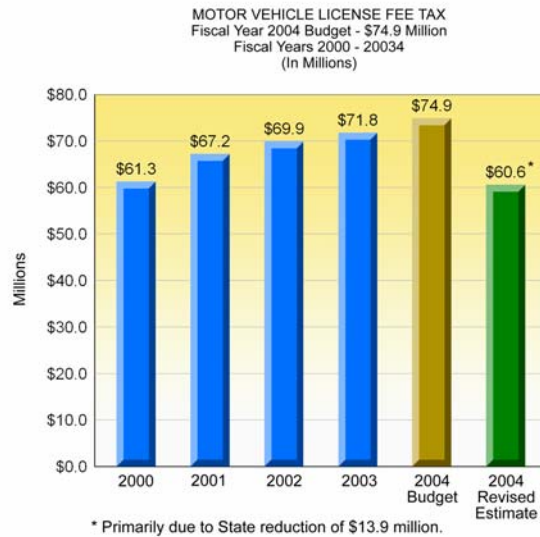
Motor Vehicle License Fees (VLF) are levied as a percentage of an automobile's purchase price, subject to depreciation, and are paid annually to the Department of Motor Vehicles at the time of registration. The fees are forwarded to the state Controller's Office, which allocates the funds to local governments. Prior to Fiscal Year 2004, approximately 25 percent of total statewide VLF revenues were allocated to counties in order to fund realignment of various health and social service programs. In Fiscal Year 2004, the percentage of VLF dedicated to counties for realignment programs increased to 28 percent. Of the remaining revenue, 18.75 percent is allocated to cities and counties for special purposes, and 81.25 percent is allocated evenly between cities and counties for general government purposes. The general allocation to cities and counties is based on each jurisdiction's relative population.

In Fiscal Year 2004, VLF revenue is budgeted at \$74.9 million, reflecting a 3 percent projected growth over Fiscal Year 2003 year-end estimates. The City's General Fund receives the entire amount of VLF revenue. As part of the state's Fiscal Year 2004 budget, former Governor Davis eliminated the backfill to local governments and increased the VLF rate paid by car owners. The backfill was eliminated on June 19, but the rate increase did not take effect until October 1, resulting in a three month "gap" in VLF funds for local governments. In Fiscal Year 2004, VLF revenues are projected to come in at \$60.6 million at year end, a shortfall of approximately \$14.3 million. Of this amount, \$13.9 million is due to this backfill loss to the state. Absent any state action, however, VLF receipts would be tracking close to budget, resulting in a total shortfall of approximately \$0.4 million. Further discussion of the state degradation of City revenue is contained in the State Impact Section of this report.

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Nationwide auto sales in December 2003 came in at 18 million units on an adjusted annual basis according to AutoData, an automotive research firm. Adjusted annual basis means the number of units that would be sold in one year if the current rate of sales were maintained, adjusting for monthly variation. December's mark was below the 18.2 million in December 2002, but was the second highest annual rate in 2003, behind only August's rate of 19 million vehicles. For the entire year, vehicle sales totaled just under 16.7 million units, a 1 percent decline from 2002, making 2003's total the lowest since 1998, though still the fifth best year on record.

Another challenge facing the automotive industry is pricing power, as consumers have become accustomed to low-interest financing and other deep incentives. According to the chief economist with the National Automobile Dealers Association, automakers have begun raising prices on new car models, but then offsetting the increases with incentives. In 2004, they plan to ease back on incentives in the hopes that a wave of new models will entice consumers to continue purchasing vehicles.

Franchise Fees

Revenue from franchise fees results from agreements that allow utility and cable companies to use the City rights-of-way. The largest source of franchise revenue for the City of San Diego is San Diego Gas & Electric (SDG&E). Under the terms of the agreement, the City charges three percent of gross sales of natural gas and electricity within the City's jurisdiction.

Seventy-five percent of SDG&E franchise revenue is deposited into the General Fund. The remaining 25 percent is deposited into the Environmental Growth Fund (EGF). One-third of the EGF is used for various environmental programs such as litter control and maintenance of open space. The remaining two-thirds of the EGF is used for debt service on open space acquisition bonds. In Fiscal Year 2004, the General Fund is budgeted to receive \$30.6 million in franchise revenue from SDG&E. Based on payments through February, the General Fund is projected to receive \$32.3 million in SDG&E franchise fees, a surplus of \$1.7 million.

In addition to the three percent franchise fee charged to SDG&E, a 3.53 percent surcharge is levied on the gross sales of electricity within the City. All revenue from this surcharge is used for the undergrounding of utility lines, and is not allocated to the City's General Fund. Because this surcharge is passed on to the consumers, it

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had to be approved by the California Public Utilities Commission, which happened in December 2002. In Fiscal Year 2004, \$38.8 million is budgeted in utility undergrounding revenue.

The City of San Diego also collects franchise fees from cable television providers and private solid waste collectors. On July 1, 2002, the franchise rate charged by the City to Cox Communications was increased from three to five percent. Effective January 8, 2004, the franchise rate charged to Time Warner Cable was also increased from three to five percent. The rate increase negotiated with Time Warner will result in additional franchise revenue of approximately \$1.1 million in Fiscal Year 2004.

The franchise fees charged to private refuse collectors are based not on a percentage of gross sales, but rather on the tons of solid waste that are collected annually. Currently, the City charges franchise fees on a two-tier system, whereby Class I haulers (those who haul less than 75,000 tons per year) are charged \$11 per ton, and Class II haulers (those who haul more than 75,000 tons per year) are charged \$12 per ton. The franchise rate was increased by one dollar effective July 1, 2003.

In Fiscal Year 2004, total City franchise fees were budgeted at \$101 million, including \$38.8 million for the undergrounding utility surcharge. The General Fund is budgeted to receive \$52.1 million. Year-to-date, franchise revenue is projected to come in at \$54.6 million for the General Fund and \$104.2 million citywide. This surplus revenue is primarily attributable to the increase in franchise rates to Time Warner Cable and higher than projected SDG&E revenues.

Accrual Adjustment

In Fiscal Year 2004 the City will make a onetime adjustment to the period in which Sales Tax revenues are accrued, resulting in an estimated \$10 million in available funding. This method of accruing Sales Tax is in accordance with Generally Accepted Accounting Principles and the business practice employed by other California cities.

General Fund Expenditures

Ongoing monitoring of department current year expenditure status indicates that some expenditures may occur above budgeted levels. Most departments will contain expenditures; however, the public safety departments have significant needs that are projected to exceed their budgets.

Police

During Fiscal Year 2004, the Police Department has held positions vacant in order to create salary savings to cover expenses such as special pay, data processing and equipment. Overtime requirements are projected to exceed the budget, with the ongoing unfunded overtime need estimated at \$7.0 million. Additionally, the Department has used a large amount of Non-General Fund revenue sources, including grants, to keep General Fund expenditures within budget. Although officer attrition (approximately seven a month), along with civilian personnel reductions, have strained the Department's ability to provide officers for basic public safety services, the Department has addressed this shortage by reassigning a number of officers from desk functions to patrol activities.

In April 2004, the Department will send 15 recruits to the Police Academy in order to increase the number of sworn officers in the City. In addition, the Department will hire five lateral transfers from other public safety organizations. Funding in the amount of \$275,000 has been authorized for the April 2004 Academy. The settlement of the lawsuit for overcharges to the City in the Civic Center Plaza building yielded a total of \$3 million to the City, \$2.3 million of which will be available for General Fund solutions, including funding for this Police Academy.

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Reductions have impacted the Department's ability to provide for safety and basic equipment to perform public safety services. However, there are opportunities for additional grant funding that the Department is actively pursuing which could provide some relief for these funding issues. The Department's focus will be on providing new vehicles for the over-aged fleet, equipment for officer safety and deferred maintenance, as well as continuing the implementation of the recommendations from the Use of Force Task Force Report.

The Police Department has expenditures in excess of the budget in data processing in addition to personnel costs such as overtime that are projected to overexpend the budget by a net \$5 million, after including savings generated in the current year.

Fire - Rescue

Fire-Rescue has established an internal spending plan as well as effective checks and balances, such as central review and documentation of all purchase requests, to ensure that only essential expenditures are made. No changes in service levels have been made, except in the CEDMat (Combustible, Explosive and Dangerous Materials) program. Due to limited funding, the Department will need to go over budget in an attempt to maintain these levels. In addition, insufficient equipment outlay budgets extending back over a number of years have reduced shelf stock to inadequate levels, which delays getting safety and rescue replacement equipment to emergency response units in major incidents.

Due to the hiring freeze, the Department has not been able to fill some clerical positions. The clerical vacancies, in the Administration, Fire Prevention, Special Operations, and Communications divisions, will be addressed by temporarily allocating essential work among remaining clerical staff where possible and by not performing or deferring lower priority tasks.

The Fire-Rescue Department has not been asked to provide expenditure savings in the current year except for compliance with the citywide hiring freeze for non-sworn positions. However, actions are being taken to ensure that the Department is able to keep expenditures in line with the additional expenditure requirements in the Department. The Fire-Rescue Department projects that, if it maintains the rate of expenditures needed to continue current service levels, it will require the Department to overexpend the budget by approximately \$3.1 million. This excludes costs related to the Cedar Fire, which are discussed further in Section II. Cedar Fire and State Impact.

Other Operating Requirements

There are several unanticipated operating needs in the General Fund, including the Public Liability Fund at approximately \$2-4 million. The Public Liability Fund provides funds for the City's self-insurance program for public liability claims and other litigation-related expenses. This fund will continue to be monitored for the remainder of the year.

The Red Light Photo Enforcement Program, now under the management of the Engineering and Capital Projects Department, will realize expenditures for vendor costs which were to be amortized over a longer period of time. In order to eliminate amortization costs and achieve a 20 percent discount in the total cost of installing, or retrofitting existing equipment, vendor costs for four camera sites will be paid in full this fiscal year. Unbudgeted costs in Fiscal Year 2004 are expected to be approximately \$500,000.

Workers Compensation costs in California continue to grow at an extraordinary rate. While some legislative remedies have been implemented, true systemic reform has not been accomplished. Despite an improved safety record and a modest reduction in claims, for the past three successive fiscal years the City's self-insured Workers Compensation system has experienced double digit increases in costs: 11, 16.3 and 14 percent in

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Fiscal Years 2001, 2002 and 2003, respectively. In particular, the medical costs portion of expenditures continues to grow unabated.

During this same period, claims per 100 employees have declined by 6.25 percent, which reflects well on the City's proactive approach to safety and the new case management process. The "injury incident rate" calculated pursuant to California OSHA standards for the largest eight City departments (responsible for over 90 percent of Workers Comp costs), declined from 13.6 percent in Fiscal Year 2003 to 12.5 percent to date in the current fiscal year. Still, in Fiscal Year 2004, Workers' Compensation and Long Term Disability costs citywide are expected to exceed the budget by approximately \$4 million. In the General Fund, the impact is anticipated to be between \$2.5-3 million, primarily due to legislative policies in Sacramento and medical costs.

Additional requirements include \$250,000 for negotiations on the Sea World lease in Mission Bay and \$100,000 for expenditures for the Mayor's Pension Reform Committee.

These unanticipated expenditures will be accommodated in the Fiscal Year 2004 Year-End Budget Adjustments Report presented for City Council consideration in June.

Section I. Status of General Fund

FISCAL YEAR 2004 GENERAL FUND REVENUE IN EXCESS OF ESTIMATES

Major Revenue in Excess of Estimates	\$ 10,000,000
Minor Revenue in Excess of Estimate	500,000
Net Civic Center Plaza Building Settlement (unbudgeted)	2,300,000
Sales Tax Accrual	<u>10,000,000</u>
TOTAL SUPPLEMENTAL REVENUE	\$ 22,800,000

FISCAL YEAR 2004 GENERAL FUND ADDITIONAL REQUIREMENTS

Police	\$ 5,000,000
Fire-Rescue	3,100,000
Operating Requirements (Public Liability Fund, Red Light Photo Enforcement, Worker's Compensation, Sea World Lease, Pension Reform Committee)	7,300,000
Police Academy	<u>275,000</u>
TOTAL EXPENDITURES IN EXCESS OF ESTIMATES OR UNBUDGETED	\$ 15,675,000

CURRENT EST. NET SUPPLEMENTAL REVENUE	\$ 7,125,000
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Although the General Fund has unanticipated expenditures in Fiscal Year 2004, revenues in excess of estimates, as described above, are more than enough to compensate for these requirements. These solutions result in an overall surplus, which is available to address the Cedar Fire and state impact, as described in the following pages.

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II. CEDAR FIRE AND STATE IMPACT

The other major challenges for the City of San Diego's General Fund in Fiscal Year 2004 are the Cedar Fire and the loss of Motor Vehicle License Fee (VLF) revenue to the State of California.

Cedar Fire

A second major challenge for San Diego in Fiscal Year 2004 has been the devastating Cedar Fire in October 2003. Although further changes to these figures may occur as staff continues to pursue reimbursement, preliminary information as of March 16, 2004 shows that the City spent \$6.3 million citywide in responding to the Cedar Fire and providing services to affected citizens.

This number is significantly reduced from the original November 21, 2003 estimate of approximately \$16 million. This number included an estimate of future preventive measures as well as a rough estimate of actual current expenditures such as: expenses directly incurred by City personnel involved while fighting the fire; damage estimates to City property including facilities, trees, guardrails, outbuildings, etc.; and possible future expenses of \$7.3 million for brush management in open space areas, which was based on the assumption that funding would be necessary to assist in future preventive efforts.

Project Officers from the Federal Emergency Management Agency (FEMA) and the Office of Emergency Services (OES) were assigned to work with City departments to refine requests and determine eligibility for reimbursement. Once City expenditures were updated based on more complete data and future brush management plans were discounted by FEMA, a more accurate assessment reflected the actual impact of the fire to be approximately \$6.3 million. The \$6.3 million reflects actual citywide expenditures and does not include lost revenue or tipping fees.

Department	General Fund Portion	Non-General Fund Portion
Development Services	\$271,140	\$0
Engineering & Capital Projects	\$400,000	\$808,044
Environmental Services	\$40,662	\$496,061
General Services	\$3,666	\$0
Information Technology & Communication	\$0	\$13,417
Metropolitan Wastewater	\$0	\$163,473
Park and Recreation	\$210,742	\$550,000
Police	\$686,125	\$0
Qualcomm Stadium	\$0	\$26,438
San Diego Fire-Rescue	\$978,771	\$0
San Diego Medical Services Enterprises	\$0	\$166,040
Transportation	\$135,778	\$0
Water	\$0	\$813,649
Local Assistance Center Costs	\$530,904	\$0
Total Costs	\$3,257,788	\$3,037,122
Anticipated FEMA Reimbursements	(\$2,443,341)	(\$2,277,842)
Anticipated OES Reimbursements	(\$610,835)	(\$569,460)
Net Anticipated City Obligation	\$203,612	\$189,820

Of the \$6.3 million spent citywide, almost \$3.3 million was spent by the General Fund. The chart above reflects actual expenditures related to Cedar Fire support in several City departments. These expenditures are broken down between General Fund and Non-General Fund. Preliminary feedback from FEMA and OES indicates that

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the costs for the Local Assistance Center in Scripps Ranch may not be reimbursed; however, the City is appealing this decision.

It should be noted that the costs associated with the Park and Recreation Department includes \$242,000 in expenditures made through the Scripps-Miramar Maintenance Assessment District (MAD) to remove impacted trees on City property in the Scripps Ranch area. Currently, City staff is working to identify available funding sources to reimburse the Scripps-Miramar Maintenance Assessment District.

These expenses have been submitted to the Federal Emergency Management Agency (FEMA) and California's Office of Emergency Services (OES). The agencies will evaluate the eligibility of the expenditures and have assured the City that eligible expenses will be reimbursed. It is expected that FEMA will reimburse up to 75 percent of eligible expenses. The remaining 25 percent is the responsibility of the state and local government. The current formula for the remaining 25 percent includes the state's share of 18.75 percent and the City's of 6.25 percent.

Senate Bill 438 (SB 438), which has been introduced in the state Senate, could authorize OES to reimburse 100 percent of the remaining 25 percent of eligible expenses after the FEMA reimbursement. On March 22, 2004 SB 438 was passed by the Assembly's Revenue and Taxation Committee. The bill will be heard next in the Assembly's Appropriations Committee. The hearing date is pending. It is also possible that costs for the building permit and refuse disposal fee waivers may be reimbursed, although current projections have not assumed such reimbursement. Updates will be provided as available. Until then, the City will prepare to fund the remaining 6.25 percent of expenses and the full amount of the fee waivers.

In addition to the direct costs of the fire, the General Fund must compensate the Environmental Services and Development Services Enterprise Funds for fee waivers that were provided to affected citizens for building permits and refuse disposal, which amounted to over \$1.3 million in unrealized revenue. This loss, originally estimated at \$1.95 million, was reduced as the departments have realized less waiver requests by homeowners than originally anticipated. The revised figure of \$1.3 million reflects the current estimate of unrealized revenues.

The City has also committed to funding a regional helicopter as an added resource for large fires, which is a further unbudgeted expenditure of over \$1.8 million. The County has committed to contributing \$35,000 per month, or \$210,000 in Fiscal Year 2004; while Sunroad Commercial (a local car dealership) and Scripps Health are expected to contribute \$200,000 each and funding from SAFE (Service Authority for Emergencies) is expected to provide \$150,000. The City will also set aside funding from the Major Events Revolving Fund to provide funding in Fiscal Year 2004. Of the total cost of \$1,840,000, outside agencies are expected to provide a total of \$760,000, while the City's Major Event Revolving Fund will contribute \$700,000, leaving \$380,000 in funding required through the City's General Fund.

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Cedar Fire Expenditures - General Fund

Cedar Fire Department Expenditures	\$ 3,257,788
Cedar Fire Fee Waivers	1,324,000
Fire Helicopter	<u>1,840,000</u>
Total GF Cedar Fire Expenditures	\$ 6,421,788
Less: FEMA Reimbursement (Est.)	\$ 2,443,341
OES Reimbursement (Est.)	610,835
Support for Fire Helicopter	<u>1,460,000</u>
TOTAL GENERAL FUND LIABILITY	\$ 1,907,612

Fiscal Year 2004 State Impact

Aside from the internal fiscal challenges and the impact of the Cedar Fire, a third pressing fiscal concern for the City of San Diego continues to be the loss of revenues due to State of California actions. In June 2003, legislation was enacted to restore the vehicle license fee to its original level, effectively tripling the fee to vehicle owners. In addition, backfill payments provided to local governments from the state's General Fund were eliminated. However, due to administrative requirements at the Department of Motor Vehicles, the increased fee was not implemented until October 1 while the backfill was eliminated immediately, thereby creating a three month "gap" in VLF funding to local governments. This funding was retained by the state in order to help balance its own Fiscal Year 2004 budget. The state considers the backfill funding from these three months to be a "loan" from local governments, and is to be repaid by the state in Fiscal Year 2006-2007. This action by the state was not budgeted by the City in Fiscal Year 2004. Therefore, full VLF payments were anticipated in the Annual Budget and a significant loss of revenue must be accommodated. Originally, it was estimated that the City would lose \$12.6 million due to this withholding of City revenues by the state; however, the actual impact to the City has increased to approximately \$13.9 million.

Fiscal Year 2004 VLF Backfill Loss for The City of San Diego

<u>MONTH</u>	<u>DEFERRED BACKFILL</u>
July	\$4,481,260
August	4,009,026
September	3,196,483
October	2,200,127
TOTAL LOSS	\$13,886,896

Notes:

1. All amounts were reported by the State Controller's Office.
2. The backfill loss for October was due to late payments from the previous months. It is unclear whether cities will be reimbursed for this backfill loss.

Upon his inauguration on November 17, Governor Schwarzenegger immediately repealed the VLF increase, although the state backfill to local governments was not reinstated. In mid-December, the Governor took

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emergency action to reinstate backfill payments. At this time, the City expects to continue receiving backfill payments for the remainder of the fiscal year, but it is not expected that the City will receive the nearly \$13.9 million that was “borrowed” by the state until Fiscal Year 2006-2007. Some controversy still surrounds the Governor’s action and the issue will bear careful observation.

In addition to the loss of VLF backfill revenue, other state funding has been decreased in Fiscal Year 2004, such as Library Foundation grants, redevelopment and support for local streets and roads, requiring reductions in services or additional burdens in the General Fund.

These actions by the state are indicative of the City’s relatively vulnerable position with regard to several of our major General Fund revenues and other sources of funds. While the City has been able to accommodate minor fluctuations in revenues and expenditures in Fiscal Year 2004, and has worked diligently to address the needs of citizens during and after the Cedar Fire in October, this unprecedented loss of revenues due to state action requires further funding and expenditure solutions.

Cedar Fire and State Impact Solutions

In order to accommodate the Cedar Fire costs that are not reimbursed or supported through other agencies, in addition to the significant impact from the state, additional solutions must be applied. The final solutions listed here will balance the General Fund in Fiscal Year 2004, barring significant unanticipated events.

Expenditure Reductions and Service Level Impacts

Public safety remains the top priority. In order to accommodate the fiscal requirements and maintain adequate service in public safety, other departments have made expenditure reductions over the past several years. In Fiscal Years 2002 and 2003, most departments were asked to save an average of three percent of their budgets during the year. Additionally, in preparing the Fiscal Year 2003 and 2004 Annual Budgets, many departments reduced their appropriations by approximately two percent and 10 percent, respectively. These reductions generated savings of \$10.3 million in the Fiscal Year 2003 Annual Budget and \$28.4 million in the Fiscal Year 2004 Annual Budget. While efficiencies have been sought throughout the General Fund in order to minimize service impacts, repeated expenditure reductions have inevitably resulted in service impacts to the public. For instance, savings have been realized in part through an extended hiring freeze, creating vacancies in many departments and extending the timelines in which some non-critical requests may be addressed. As presented in the Fiscal Year 2004 Annual Budget, hours of operation were reduced at recreation centers and libraries, and reductions were made to graffiti control contracts and non-emergency building repair.

Additional expenditure reductions are being achieved in the current year by most non-public safety General Fund departments, which were asked to save five percent of their budgets. The following will provide a status of several of the major General Fund departments, including current year expenditure reduction plans, when applicable, and their impacts, which are scheduled to result in a savings of approximately \$10.5 million by year-end.

Park and Recreation

As a result of the citywide hiring and expenditure freeze, and the budget reductions from Fiscal Year 2004 and previous years, the Park and Recreation Department has reduced levels of staffing and supplies. The Department currently has over 85 vacancies. Ranger vacancies have resulted in reduced patrols and enforcement in the developed regional parks and reduced safety patrols and educational programs in open space parks. Vacancies in maintenance staff and the deferral of equipment purchases have impacted maintenance of developed parks, neighborhood/community parks, recreation centers and open space areas. Impacts include reduced cleanliness of park areas, delayed irrigation repairs, less frequent mowing, increased turf stress and deferral of other needed

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repairs. Overtime and temporary assignments, both of which are unbudgeted additional expenses, have increased. Maintaining adequate and safe staffing levels at some centers has become increasingly difficult, and programs at recreation centers have been significantly reduced. Recreation Councils must provide basic supplies such as copier paper and markers in some areas. The community matching funds program has been reduced by approximately 70 percent for Fiscal Year 2004 and, as a result of the expenditure freeze, the remaining balance of \$50,000 will not be allocated to new programs, effectively eliminating the program for this year.

Library

In Fiscal Year 2004, three positions will be kept vacant, including 2.00 Youth Service Librarians at branch libraries and 1.00 Senior Clerk-Typist in charge of the Delivery Section. General Fund expenditures for computer replacements and other data processing expenditures will be reduced by \$414,000. General Fund expenditures for library materials will be reduced by \$1.4 million.

When combined with reductions taken in Fiscal Years 2002 and 2003, the Library Department's General Fund materials budget has been cut by over \$2.4 million. The loss of these funds reduces the Library's opportunity to purchase some materials that are only available for a limited time. The Library has been working to obtain other sources of funding that will enable the Department to continue its library materials acquisitions.

General Services - Facilities Division

As in the previous fiscal year, for the remainder of Fiscal Year 2004 Facilities will continue to defer non-emergency General Fund facility repairs until monies become available. Currently, the Division only responds to emergency or health and safety related General Fund facility repair calls, unless a repair is made as an ancillary request to an emergency or health and safety call.

GENERAL FUND REQUIREMENTS RESULTING FROM:

Cedar Fire	\$ (6,421,788)
State Take Away (VLF)	<u>(13,886,896)</u>
TOTAL OTHER REQUIREMENTS	\$ (20,308,684)

REQUIRED GENERAL FUND SOLUTIONS

FEMA/OES Reimbursement (estimate)	\$ 3,054,176
Support for Fire Helicopter	1,460,000
Non-Public Safety Department Reductions/Savings	10,722,000
General Fund Revenue in Excess of Estimates (available from Section I.)	<u>7,125,000</u>
TOTAL GENERAL FUND SOLUTIONS	\$ 22,361,176

NET GENERAL FUND SURPLUS	\$ 2,052,492
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Austere spending plans in each department and the diligent pursuit of reimbursements and alternative funding sources for items such as the Fire Helicopter allow the City's General Fund to accommodate these unexpected expenditures in Fiscal Year 2004. Based on the solutions presented in this report, the City anticipates balance in

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all funds by fiscal year end, as required by the City Charter. The remaining revenue will be used to help fund the Fiscal Year 2005 budget.

FISCAL YEAR 2004 SUMMARY

In Fiscal Year 2004, the need to allocate additional resources to unfunded needs, particularly public safety, stretches the limits of our relatively low revenue base, even after utilizing some revenue surpluses as a result of the improving economy, settlements and other fund transfers, if necessary. Due to these obstacles, the City is unable to fully fund all of the non-public safety services and support that were anticipated in the Fiscal Year 2004 Annual Budget. Expenditure requirements for the Cedar Fire and loss of VLF revenue to the state added to the significant fiscal challenges in the General Fund. The chart below summarizes the various actions taken to balance the General Fund, as discussed in this report.

GENERAL FUND ESTIMATED REQUIREMENTS	GENERAL FUND	CEDAR FIRE	STATE	TOTAL
State Impact			\$ 13,886,896	\$ 13,886,896
Cedar Fire Department Expenditures		3,257,788		3,257,788
Cedar Fire Fee Waivers		1,324,000		1,324,000
Fire Helicopter		1,840,000		1,840,000
Police Overexpenditures	5,000,000			5,000,000
Fire-Rescue Overexpenditures	3,100,000			3,100,000
Other Operating Requirements	7,300,000			7,300,000
Police Academy	275,000			
TOTAL REQUIREMENTS	\$ 15,675,000	\$ 6,421,788	\$ 13,886,896	\$ 35,983,684
PROPOSED SOLUTIONS				
Major Revenue Surplus	\$ 10,000,000			\$ 10,000,000
Minor Revenue Surplus	500,000			500,000
Civic Center Plaza Building Settlement	2,300,000			2,300,000
Sales Tax Accrual	10,000,000			10,000,000
FEMA/OES Reimbursement (Est.)		3,054,176		3,054,176
Support for Fire Helicopter		1,460,000		1,460,000
Non-Public Safety Department Reductions/Savings			10,722,000	10,722,000
TOTAL SOLUTIONS	\$ 22,800,000	\$ 4,514,176	\$ 10,722,000	\$ 38,036,176
NET SURPLUS/(DEFICIT)	\$ 7,125,000	\$ (1,907,612)	\$ (3,164,896)	\$ 2,052,492

The solutions described in this report do not address any long term solutions for the pension system. However a tentative settlement has been reached in the pending litigation regarding the funding of the system, but that tentative settlement will not impact the Fiscal Year 2004 budget. Updates will be provided on the pension status as available.

The Fiscal Year 2004 General Fund is projected to be balanced with the aforementioned actions, unless unanticipated events occur between now and the end of the fiscal year. Further unanticipated requirements would necessitate the implementation of other appropriate measures to achieve the City Charter requirement that a balanced budget be in place by the end of the fiscal year. It is important to note that the General Fund reserve was not used to maintain a balanced budget for Fiscal Year 2004.

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FISCAL YEAR 2005 PRELIMINARY OUTLOOK

In reviewing the preliminary outlook on Fiscal Year 2005 and the Proposed Budget that will be presented to the Mayor and City Council in May, there are four key points that will be highlighted:

I. Fiscal Year 2005 Economic Environment

This section identifies economic conditions that are impacting the preparation of the Proposed Budget. In Fiscal Year 2005, growth of major revenues is expected to be greater than in recent years.

II. General Fund Budget Strategy

This section identifies expenditure requirements, General Fund Budget balancing strategies, and proposed revenue enhancements. The Fiscal Year 2005 Proposed Budget will be balanced using revenue growth and expenditure reductions, which are in addition to expenditure reductions made in Fiscal Years 2003 and 2004.

III. General Fund Revenue Options

This section summarizes potential revenue ideas that have been identified as a result of City Council requests. Revenue enhancements are an alternative to further reductions, given that expenditures are increasing at a faster rate than existing revenues.

IV. State Impact

This section includes a summary of the potential impacts of the State of California's deficit on the City's Fiscal Year 2005 Proposed Budget. The Fiscal Year 2005 Proposed Budget submitted to the Mayor and Council in May will not incorporate potential state actions, but will include impacts as a result of the passage of Propositions 57 and 58 on March 2, 2004.

I. FISCAL YEAR 2005 ECONOMIC ENVIRONMENT

Heading into Fiscal Year 2005, the economy is poised to provide additional enhanced resources for the first time in nearly three years. Indicators at all levels are pointing upward for the upcoming year, though a few lingering issues continue to impede the prospects for widespread growth. San Diego's economy, which has consistently outperformed both the state and national economies over the past three years, should continue to grow. Overall, the economic outlook for Fiscal Year 2005 is positive.

In the third quarter of 2003, Gross Domestic Product (GDP), the broadest measure of all goods and services produced in the U.S., grew at an annual rate of 8.2 percent; more than double the 3.3 percent rate in the second quarter. Also in the third quarter, corporate profits grew 30 percent according to the U.S. Commerce Department, the largest year-over-year gain in 19 years. GDP growth in the fourth quarter slowed to a more sustainable 4.1 percent, down substantially from the previous quarter, but still indicative of a growing economy. In total, the economy's performance in the third and fourth quarters of 2003 represents the fastest back-to-back quarterly growth since the first half of 1984.

The main contributors to the growth in the past two quarters have been consumer spending and business fixed investment, particularly in equipment and software. The Commerce Department report showed that consumer spending increased 2.7 percent in the fourth quarter, following a 6.9 percent increase in the third quarter, while corporate investment in equipment and software grew at a 15.1 percent annual rate in the fourth quarter, following a 17.6 percent growth in the previous period. Business spending on nonresidential structures, or business capital spending, continues to struggle, however, falling 7.1 percent in the fourth quarter. Many

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economists feel that a rebound in business capital spending is necessary to sustain a full economic recovery. According to *Global Insight*, a leading economic research and analysis firm, business capital spending should pick up in the second quarter of 2004, as increased jobs and manufacturing activity lead to an increase in office and industrial construction.

In California, the unemployment rate was 6.2 percent in February, according to the California Employment Development Department (EDD), matching January's rate. However, the rate in both months is down substantially from the 6.5 percent in December 2003 and a high of 6.9 percent in July of last year. The EDD estimates that the number of Californians holding jobs increased by 7,000 in February to an all time high of 16,487,300. February's gain comes on the heels of an increase of 133,000 in January, a large enough jump to lower the unemployment rate despite a sizeable increase in the labor force. Still, the California economy remains fragile, especially in the Bay Area, where nearly 337,000 jobs were lost between the first quarter of 2001 and the third quarter of 2003.

Locally, San Diego's economy continues to outperform both the state and national economies. The San Diego Regional Chamber of Commerce Economic Research Bureau estimates that the Gross Regional Product (GRP) in 2003 was a record \$129.2 billion, a 5.5 percent increase over the 2002 estimate. The Chamber is forecasting even stronger growth in 2004, projecting a 6.2 percent increase in the GRP to \$137.2 billion. In February, San Diego County's unemployment rate fell to 3.9 percent on an unadjusted basis, down from a revised 4.1 percent in January and 4.4 percent in February 2003. Among the bright spots for the San Diego region are the housing market, which has seen continual increases in both median price and number of sales, and the tourism market, which set a record in 2003 with 26.4 million people visiting the region. These and other local factors were discussed in greater detail in the General Fund Revenue section of the Fiscal Year 2004 Status.

II. GENERAL FUND BUDGET STRATEGY

The primary focus of the budget development process is to forecast revenues and take into consideration both the ongoing operating requirements of departments and expenditure priorities of the Mayor and City Council and the citizens. Budgeting is a revenue-driven process. As the Blue Ribbon Committee report on City Finances acknowledged, San Diego begins the budget process from one of the lowest per capita revenue bases of any major city in the United States. In developing a fiscal plan within this economic environment, the proposed budget strategy has included using the revised Principles of Budgeting and Finance, in which a primary principle is to use ongoing revenue to support ongoing expenditures. Because General Fund revenues continue to be further eroded by the State of California and are not growing at the same pace as ongoing expenditure requirements, corresponding reductions to City operations are required.

One element of the Proposed Budget strategy has been to exclude the proposed and potential adjustments due to the State of California budget deficit. The situation at the state level continues to be debated; therefore it is premature to build a proposed budget that reduces services without full knowledge of the state budgetary actions. The state budget situation, including proposals to shift an additional \$14.7 million of City of San Diego revenue in Fiscal Year 2005, is discussed further in this report. An overview of the City's current budget situation and proposed solutions are presented in the following section.

Fiscal Year 2005 General Fund Revenue Projections

The growth in the major General Fund revenues, which comprise 68.5 percent of all General Fund revenue, is primarily driven by the economy. The major General Fund revenues include Property Tax, Sales Tax, Transient Occupancy Tax, Motor Vehicle License Fees and Franchise Fees. Fiscal Year 2005 revenue estimates reflect a recovering economy, as previously discussed in this report. The net growth in the major revenues for Fiscal

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Year 2005 is currently estimated between \$30-32 million, depending on the assumed outlook for Fiscal Year 2005 economic conditions. Net growth in minor revenues is currently estimated at \$10-11 million. Development of revenue estimates for Fiscal Year 2005 will continue to be refined as the Proposed Budget is finalized.

Other available revenue in Fiscal Year 2005 includes increased lease revenues of \$2-3 million, delayed Capital Improvement Program projects of \$5-6 million, onetime fund transfers of \$7-8 million, departmental revenue adjustments of \$2-3 million and carryover of \$10-12 million from Fiscal Year 2004, which includes Tobacco Settlement money. Proposals for new fees could generate an additional \$6-7 million. All of these revenues are being considered in developing the Fiscal Year 2005 Proposed Budget.

Fiscal Year 2005 General Fund Expenditure Projections

Reliance on the annual growth of existing revenues, absent the provision of new revenue sources and including the permanent loss of a significant portion of Property Tax to the state, greatly limits the City's ability to meet ongoing operating requirements and City Council priorities. Examples of the City's anticipated expenditure obligations follow and the following table summarizes major expenditure growth over Fiscal Year 2004 levels.

Personnel-Related Obligations

In Fiscal Year 2005, the City will enter into the final year of the current negotiated salary and benefits contracts with each of the four employee unions.

The following table summarizes expenditure growth in negotiated salaries and benefits, including the City contribution to the retirement system, above Fiscal Year 2004 levels. In addition, a tentative settlement has been reached in the litigation against the City for underfunding of the retirement system. While the agreement must still be approved by the courts, one component of the tentative agreement is that the City will contribute a total of \$130 million (for all funds) to the system in Fiscal Year 2005, which includes an increase of an estimated \$15 million over previously planned levels for the General Fund. This additional contribution is included in the Fiscal Year 2005 Proposed Budget.

Public Safety Additions

In accordance with recent discussions at the Public Safety and Neighborhood Services Committee, the Fiscal Year 2005 Budget proposes to include additional funding for the Police and Fire-Rescue Departments. In the Police Department, funding is proposed for four Police Academies in Fiscal Year 2005 and to provide some funding in the areas of overtime, deferred maintenance, and equipment and vehicles. In the Fire-Rescue Department, some funding is also proposed for overtime, deferred maintenance, equipment and apparatus, consistent with the Public Safety and Neighborhood Services discussion.

New Facility Obligations

Operating expenses of new facilities previously approved by the Mayor and City Council are also being proposed. Facilities scheduled to open in Fiscal Year 2005 include the North University City Library, the Rancho Peñasquitos Skate Park, Otay Valley Regional Park and various joint-use areas, community parks and park maintenance improvements. Operating expenses related to the annualization of Fiscal Year 2004 new facilities such as Fire Station #46 in the Black Mountain Ranch area, the Riford/La Jolla Library and other park projects such as the Tecolote Nature Center expansion are also proposed for consideration.

Non-Discretionary Expenses

Annual increases in costs for such items as insurance, energy, and vehicle usage are planned in the upcoming budget year.

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The following list of Fiscal Year 2005 General Fund changes in funding requirements is not intended to be complete, but identifies the approximate change in cost or major revenue receipts currently projected in these categories for Fiscal Year 2005.

INCREASED REVENUE AVAILABLE TO FUND FISCAL YEAR 2005 BUDGET

Net Estimated Additional Revenue Available	\$ 66-70 million
Proposed New or Increased Fees	\$ 6-7 million

Net Estimated Increased Revenue Available	\$ 72-82 million
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MAJOR EXPENDITURE GROWTH OVER FISCAL YEAR 2004 BUDGET

Public Safety Annualizations of FY 2004 and FY 2005 negotiated salaries and benefits (sworn)	\$ 32-35 million
Non-Public Safety Annualizations of FY 2004 and FY 2005 negotiated salaries and benefits	\$ 23-25 million
General Fund Retirement Settlement Contribution	\$ 15.0 million
Public Safety additions	\$ 11-13 million
General Fund Reserve contribution	\$ 2-3 million
New facility and annualization operating costs (Park and Recreation and Library Facilities)	\$ 2-3 million
Non Discretionary Accounts (Insurance, Energy, Vehicle Usage, etc.)	\$ 3-4 million
Estimated Department Increases for Cost of Operations	\$ 7-8 million
Estimated Reductions in City Operations	(\$23-24) million

Net Estimated Expenditure Growth	\$ 72-82 million
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As the cost of doing business increases, major revenue growth, reduced by the continuing state revenue shifts, are not sufficient to cover anticipated and committed expenditures. New fees and onetime revenues are proposed in order to balance the budget, as summarized above and discussed further below. These onetime

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revenues will be used for onetime expenses consistent with our budget principles. The General Fund Reserve is not proposed to be used in Fiscal Year 2005. In addition, there is still a need to make expenditure reductions. As a result, the development of the Proposed Budget will include reductions in City operations of approximately \$23-24 million. Through the years, we have accumulated deferred maintenance and unfunded needs in public safety and non-Public Safety departments. Data is being collected now to estimate the total unfunded needs in the City and this information will be presented to the Mayor and City Council along with the Fiscal Year 2005 Proposed Budget.

Fiscal Year 2005 General Fund Solutions

Opportunities to help achieve a balanced Fiscal Year 2005 General Fund Proposed budget will include the following:

1. Reductions in City Operations:

In the Fiscal Year 2005 Proposed Budget, non-Public Safety programmatic reductions are proposed in citywide operations. Total reductions are currently estimated to be \$23-24 million, or the equivalent of over three percent of the Fiscal Year 2004 General Fund.

2. Revenue Enhancements:

The Fiscal Year 2005 Proposed Budget is being developed with proposed revenue enhancements which require City Council approval when the final budget is approved.

Various new and existing fee increases will be included in the Fiscal Year 2005 Proposed Budget, some of which may be enacted or increased administratively, others of which require City Council approval. These fees are proposed to result in a net revenue increase of approximately \$6-7 million, which is equal to less than one percent of the Fiscal Year 2004 General Fund. As occurred last year during the budget hearings, a list of fee options in excess of \$6-7 million will be provided that the City Council may consider in order to arrive at a \$6-7 million increase.

3. Requests for Council Action:

- a. Pursuant to the Library Ordinance, the City Manager shall present a Proposed Budget which appropriates an amount equal to at least six percent of the Proposed General Fund budget for Fiscal Year 2005 to the Library. However, it is recommended that the ordinance be suspended in Fiscal Year 2005 and the City Manager's Proposed Budget will use these monies to fund priorities such as Public Safety.
- b. Pursuant to the Mission Bay Ordinance, Mission Bay lease revenues in excess of \$20 million are to be directed in part to special funds. One-quarter of excess revenues, up to \$10 million are directed to the Regional Park Fund and the Mission Bay Improvement Fund, each. However, it is recommended that the ordinance be suspended in Fiscal Year 2005 and the City Manager's Proposed Budget will use these monies to fund priorities such as Public Safety.
- c. Council Policy 100-20 requires that the General Fund reserve be maintained at three percent of the General Fund. In addition, it specifies that, in years when revenue growth exceeds two percent, the City Manager shall propose in his Annual Budget an increase to the General Fund Reserve equal to at least 10 percent of the General Fund revenue increase in excess of two percent. It is proposed that the requirement to increase the reserve in accordance with General Fund revenue growth in excess of two percent in Fiscal Year 2005 be suspended in Fiscal Year 2005. The City Manager would use these funds for priorities such as Public Safety. The General Fund Reserve would be maintained at three percent in Fiscal Year 2005 by increasing the reserve by an estimated \$2-3 million.

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4. Other:

- a. The Fiscal Year 2005 Proposed Budget assumes the utilization of Community Development Block Grant (CDBG) funds to support projects such as purchasing fire equipment, mandated Americans with Disabilities Act facility improvements and Neighborhood Code Compliance Services, which are eligible for the use of CDBG funds. If these monies are not utilized, further reductions would be necessary.
- b. In addition to reductions to services and departments within the City, reductions will be proposed in arts and economic development awards through Transient Occupancy Tax/Special Promotional Programs and Social Services Programs throughout the City. If approved, these reductions will make funding available for General Fund priorities such as Public Safety.

If implemented, these actions will contribute to a balanced Fiscal Year 2005 Proposed Budget. However, state actions, as detailed later in this report, could create a further funding shortfall of approximately \$15 million, which is not currently accommodated in the Proposed Budget.

III. GENERAL FUND REVENUE OPTIONS

The following provides brief summaries of a number of potential revenue enhancement options. Several of these revenue enhancement options were discussed in greater detail in City Manager Report No. 03-061 (Revised), presented to the Committee on Rules, Finance and Intergovernmental Relations on April 2, 2003. Although several of these options may be viable, some will require significant time for legal review, analysis and preparation prior to potential implementation. Additionally, most of these options require voter approval, which further extends the timeframe for implementation.

Business License Tax

Business License Taxes are charged to businesses for the privilege of conducting operations within a city's boundaries. These taxes are levied in many different ways, most commonly as a percentage of gross receipts or a fixed charge per employee. Often, rates are tiered depending on the size of the business or number of employees. Different rates are often charged to different types of businesses. Currently the City of San Diego levies a Business License Tax that is based on the number of employees. For businesses with less than 13 employees, the City charges a flat rate of \$34. For businesses with 13 or more employees, the City charges a flat rate of \$125 plus \$5 per employee. Based on Fiscal Year 2002 actual figures, doubling the Business License Tax would generate approximately \$5.3 million per year in additional General Fund revenue. Additional business related taxes could include an Admission Tax, a Parking Lot Tax, a Rental Car Tax, and a Valet Parking Tax. Further research would be necessary to estimate the potential impact and requirements of these taxes.

Paramedic Subscription Program

In an effort to enhance the City of San Diego's first-response capabilities to medical emergencies, the San Diego Fire-Rescue Department is developing a proposal to institute a voluntary first-response Paramedic Subscription Program. Under this program, households and businesses would have the option of paying an annual subscription fee. Those who elect to pay the fee would not be charged if first-response medical service is required. Those who choose not to pay the voluntary subscription fee would be billed for emergency medical first-response. Transport fees would still be charged to all users when applicable.

Property Transfer Tax

The Property Transfer Tax, sometimes referred to as a documentary transfer tax, is paid on the sale of any real property. The tax is based on the purchase price of the property at the time of sale. Most cities levy a so-called "conforming" tax, whereby the county charges \$1.10 per \$1,000 and the city charges \$0.55 per \$1,000. The city tax is then credited against the county tax, such that both the city and the county receive \$0.55 per \$1,000 of the

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sale price. Some cities levy a “non-conforming” property transfer tax at a rate above \$0.55 per \$1,000. In these cases, the city tax is not credited against the county tax. The county receives the full share of the \$1.10 per \$1,000, and the city receives the amount generated from its own tax rate. Currently, San Diego levies a “conforming” tax rate of \$0.55 per \$1,000. Based on Fiscal Year 2002 actual receipts, an increase in the property transfer tax to \$2.75 per \$1,000, a rate equivalent to that in Sacramento, could generate over \$28.1 million a year in additional General Fund revenue.

Public Safety Property Tax Assessment

An additional Property Tax Assessment for public safety services could be levied on new development in the City. As proposed in the City of Elk Grove, California, for example, this tax would not be levied on current homes, only future development, and would be designed to increase with inflation. Service levels to the new developments would not differ from services to established communities. Because in most cases each new household costs a city more in services than it contributes in taxes, the City has been falling behind in its ability to recover the costs of basic services such as public safety. Based on new residential construction in 2002, a Public Safety Property Tax Assessment of \$275 on each new dwelling unit would generate approximately \$1.9 million in General Fund revenue.

Refuse Collection Fee

The Refuse Collection Fee is a charge for the service of residential refuse collection and disposal. It is levied as a monthly charge per refuse container to each household that receives municipal refuse collection service. San Diego is the only major California city that does not attempt to recoup at least a portion of the cost of providing refuse collection service. A flat monthly rate of \$10-13 per household would generate \$39 - \$45 million, fully recovering the cost of residential refuse collection. While instituting a refuse collection fee would not require a vote under Proposition 218, majority approval would be required to amend Municipal Code Section 66.0127, enacted by voters in 1919 to prohibit the collection of fees for residential refuse collection or disposal.

Storm Drain Fee

Storm Drain Fees are levied as parcel charges, sometimes adjusted for the parcel area and amount of impervious surface space. The City of San Diego currently collects a fee of \$0.95 per single-family residence and a fee based on water use for multi-residential, commercial and industrial properties. These fees, collected on the City’s water and sewer utility bills, generate approximately \$6 million per year. If this fee were to be increased by \$1 per month for residential properties, with comparable fees for commercial properties, additional revenue of approximately \$6.3 million could be generated. Before a fee increase could be proposed, an engineering feasibility study would have to be undertaken citywide.

Transient Occupancy Tax

The Transient Occupancy Tax (TOT) is a tax imposed on persons occupying a room in a hotel, motel, inn, or other lodging facility for less than 30 consecutive days. The tax is levied as a percentage of the total rent charged to the occupant for use of the room. Currently, the TOT charged by the City of San Diego is 10.5 percent. This rate is one of the lowest among major California cities. For instance, Anaheim charges a TOT of 15 percent, while San Francisco and Los Angeles both charge 14 percent. Based on Fiscal Year 2002 actual figures, a one percent increase in San Diego’s TOT would generate approximately \$9.4 million per year in additional General Fund revenue. A proposed increase of 2.5 percent on the March 2, 2004 ballot failed with 61 percent of the vote, while 66 percent was required to pass.

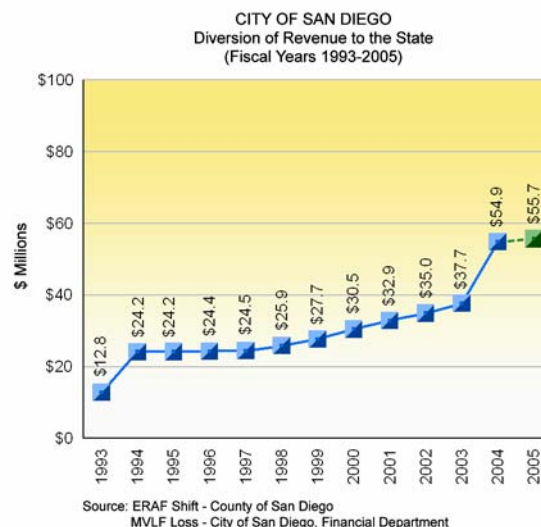
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IV. STATE IMPACT

As previously mentioned, the State of California continues to suffer significant fiscal challenges. However, the Governor's proposals to issue an economic recovery bond (Proposition 57) and constitutionally require a balanced budget (Proposition 58) both passed in the March 2, 2004 election. Severe and unpopular reductions alluded to were the economic recovery bond to fail may now be avoided, although the independent Legislative Analyst's Office (LAO) cautions that recent trends indicate that revenues, while improving, may fall short of the optimistic expectations set forth in the Governor's budget proposal. The LAO also warns that the current proposal does not fully address the structural imbalance between revenues and expenditures, which is estimated to result in a \$7 billion deficit in 2005-06 absent further corrective action.

The passage of Proposition 57, the Economic Recovery Bond Act, does have repercussions for the City of San Diego. The bond will include financing through Sales Tax, which will be diverted from the local municipalities, to be replaced with Property Tax. However, part of the repayment will be delayed for up to 18 months, resulting in a loss of \$1-2 million for the City of San Diego, and payments of the Property Tax are likely to be semi-annual, rather than quarterly, presenting a potential cash flow challenge to the City. These effects will be included in the Fiscal Year 2005 Proposed Budget.

Each year, the State shifts an ever-increasing amount of Property Tax from the City of San Diego to the Educational Revenue Augmentation Fund (ERAF). In Fiscal Year 2004, it is projected that approximately \$41 million was shifted from the City and that, since Fiscal Year 1993, the total amount shifted from the City to ERAF has been almost \$341 million. Governor Schwarzenegger's proposed budget includes an additional Property Tax shift to ERAF from local governments in Fiscal Year 2005. The City's share of this shift would be approximately \$9.5 million which, when added to the regular shift estimated at over \$41 million, brings the total amount shifted since Fiscal Year 1993 to an estimated \$390 million, in ERAF alone. Additionally, the Governor has proposed eliminating the jail booking fees reimbursement of \$5.2 million, which brings proposed shifts from the City of San Diego's General Fund to nearly \$14.7 million. The chart below shows the historical diversion of revenue by the state from the City including the additional proposed state diversion in Fiscal Year 2005.



Several Non-General Fund impacts are also proposed. These include reductions to grant programs such as Community Oriented Policing Services (COPS), Library Foundation and Arts and Culture grants of almost \$1.5

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million, ERAF shifts from the Redevelopment Agency of \$2.65 million in Fiscal Year 2005 and in every future year, and reductions to transportation funding of over \$200 million to the San Diego region.

State of California "May Budget Revise"

The State Constitution requires that the Governor submit a budget to the Legislature by January 10 of each fiscal year. An update of the State's General Fund revenues and changes in expenditures, otherwise known as the May Revise, is usually due by May 14. By constitutional requirement, the Governor's Budget must be accompanied by a Budget Bill. The State constitution also requires that the Legislature pass the bill by June 15 of each fiscal year. The City of San Diego Charter mandates, however, that the City Manager release the City's Proposed Budget by the first City Council meeting in May. Consequently, only preliminary information regarding the State of California's fiscal situation and budget proposals that relate to local governments is available at this point in the City's budget process. In the City's June Revision, released in mid-June, updated revenue and expenditure data, including the State's budget status, will be provided to the Mayor and City Council prior to budget deliberations. Due to the ambiguity concerning state decisions, the City of San Diego's Fiscal Year 2005 Proposed Budget will not include proposed impacts as described above. However, the Proposed Budget anticipates including a list of options for service level reductions and revenue enhancements should the State of California continue to take additional City revenues.

FISCAL YEAR 2005 GENERAL FUND PROPOSED BUDGET SUMMARY

Although major revenues are expected to perform well in Fiscal Year 2005, the continued erosion of the City's revenue base by the state has caused expenditures to outpace this growth, requiring reductions in the budget in order to accommodate required expenditures such as salary and benefits adjustments, public safety needs and other mandated requirements. Furthermore, state erosion of City revenues is causing service reductions. Revenue enhancements are presented as an alternative to certain reductions and may create the possibility of funding currently reduced programs in the future.

CONCLUSION

As required by the City Charter, the City is anticipating ending Fiscal Year 2004 with all funds in balance. In addition, this report has presented an overview of the Fiscal Year 2005 General Fund Proposed Budget which will be presented to the Mayor and City Council on May 3, 2004.

Respectfully submitted,



Michael T. Uberuaga
City Manager

Attachments:

- Appendix A – Other General Fund Revenues
- Appendix B – Enterprise Fund Status
- Appendix C – Special Revenue Fund Status
- Appendix D – Internal Service Fund Status

APPENDIX A - Other General Fund Revenues

Safety Sales Tax

Safety Sales Tax is the result of a one-half percent sales tax levy for local public safety that became effective January 1, 1994, as a result of the passage of Proposition 172. The tax is imposed by the state and distributed to counties based on their proportionate share of statewide taxable sales. Counties then allocate the fund to the county and cities within the county based on each jurisdiction's proportionate share of property tax loss due to ERAF shifts in 1993-94. Senate Bill 8 changed the allocation system for Proposition 172 revenue and nominally increased the cap on the share that the City of San Diego and other cities receive.

The Fiscal Year 2004 Budget for Safety Sales Tax is \$6.2 million, assuming a three percent growth over Fiscal Year 2003 year-end estimates. Of this \$6.2 million, approximately \$2.8 million is allocated for debt service payments on Fire and Lifeguard facility improvements, with the remainder allocated to the General Fund for public safety purposes such as recent additions for support for new fire facilities and funding of required overtime and salary increases. Since the introduction of Safety Sales Tax, the growth of City public safety expenditures has always significantly exceeded growth in Safety Sales Tax. As a result, although all Safety Sales Tax revenue is allocated to accommodate the increasing costs of public safety services, this revenue is not sufficient to fully fund the many public safety needs in the City. Based on current year receipts, Safety Sales Tax is projected to come in at \$6.5 million, a 4.8 percent increase over the budgeted amount. The General Fund is projected at \$3.8 million, approximately \$0.4 million above budgeted levels.

Property Transfer Tax

A Property Transfer Tax is levied on the sale of real estate. The County charges \$1.10 per \$1,000 of the sale price at the time ownership of real property is transferred. The City of San Diego charges a "conforming rate" of \$0.55 per \$1,000 of sale price, which is then credited against the County's charge. Thus, both the City and the County receive \$0.55 per \$1,000. Funds are collected by the County Recorder and distributed monthly to the City.

In Fiscal Year 2004, Property Transfer Tax was budgeted at \$8.5 million, a 6 percent projected growth over Fiscal Year 2003 year-end estimates. All revenue received from the Property Transfer Tax goes into the General Fund. Year-to-date activity has resulted in a year-end projection of \$10.0 million, \$1.5 million over the budgeted amount. This projection is reflective of an exceedingly strong real estate market. Housing prices continue to climb as homebuyers take advantage of sustained low mortgage rates, and commercial real estate sales have remained strong with such notable sales as the First National Bank Center for \$111.5 million, Hazard Center for \$100 million, and the Washington Mutual Tower for \$35 million.

Licenses and Permits

Licenses and permits generate revenue for the purpose of recovering the costs associated with regulating certain activities. This regulatory function is typically performed by government due to the concern for public safety. Included in this category are business license taxes, the rental unit tax, regulatory business licenses, bicycle licenses, street and curb permits, alarm permits, and referral fees received from the City's towing operators.

The business license tax for businesses with 12 or fewer employees is a flat rate of \$34. Business license taxes for businesses with 13 or more employees are based on a flat rate of \$125 plus a fee of \$5 per employee. Rental unit taxes are calculated as a flat rate plus a fee per rental unit. Currently, the rental unit tax has three rate tiers for residential properties and two rate tiers for hotel/motel properties.

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Fiscal Year 2004 total City revenue from licenses and permits is budgeted at \$57.6 million, \$23.4 million of which is allocated to the General Fund. The year-end projection for the General Fund is \$22.2 million. The deficit is primarily attributable to reduced revenue from parking meters.

Fines, Forfeitures, and Penalties

This category includes revenue generated from monetary sanctions associated with the violation of a law or regulation. Subcategories of fines, forfeitures, and penalties revenue include California Vehicle Code violations, City parking and ordinance violations, and litigation awards.

Fiscal Year 2004 General Fund fines and forfeitures are budgeted at \$29.4 million. The year-end projection is \$28.3 million, reflecting lower than anticipated revenue from parking citations.

Interest Earnings

The City Treasurer is responsible for investing the City's cash assets exclusive of City Pension Trust Funds. All City funds are pooled and invested together to facilitate increased flexibility in the management of the portfolio for the purpose of maximizing interest earnings. Fund investment must be consistent with the City investment policy and the state's restrictions on types of investments. Investments may extend out to five years, depending on the climate in the investment marketplace and the cash flow requirements of the City.

Fiscal Year 2004 interest earnings are budgeted at \$1.2 million. The year-end projection is expected to be slightly above budgeted levels, at \$1.5 million.

Revenue from Other Agencies

A significant amount of revenue received by the City is initially collected by other agencies and then returned (or subvended) to the City. The subcategories of revenue from other agencies include state grants and allocations, federal grants, and the reimbursement for general City services provided to the Unified Port District.

The Fiscal Year 2004 budget for revenues received from other agencies is \$10.4 million. The year-end projection is \$11.1 million.

APPENDIX B - Enterprise Fund Status

Metropolitan Wastewater

The City of San Diego's Metropolitan Wastewater Department (MWWD) provides a regional wastewater service that treated approximately 180 million gallons per day in Fiscal Year 2003. MWWD treats wastewater from 16 cities and districts in a 450 square mile area stretching from Del Mar to the North, Alpine and Lakeside to the east, and the Mexican border to the south. MWWD manages all of the resources needed to operate the current Metropolitan Sewerage System, serving a population of 2.0 million, and provides new facilities for improved treatment or additional capacity.

With the City Council approval of a rate increase of 7.5 percent per year for four years, starting in March 2002, MWWD embarked upon an accelerated program of pipeline replacement/rehabilitation and a system-wide preventative-maintenance cleaning schedule for roughly 3,000 miles of municipal sewer lines. Because portions of the system are cleaned with a frequency of greater than once a year, this will result in the cleaning of approximately 4,500 miles of sewer lines during the next two years. This mileage estimate provides for a complete cleaning regimen for the entire system that will run parallel with existing cleaning schedules, including the non-right-of-way portions such as those identified in the Canyon Access Program, as well as problematic right-of-way pipe sections as they are identified.

In addition to the focus on municipal sewer main cleaning, a televising assessment program has also been initiated for 1,200 miles of municipal sewer pipeline through August 2005. Since concentrating on these older sections of pipeline, the Department has found the system in a better than anticipated condition and, as a result, is reducing the rehabilitation and replacement of deteriorated pipelines from 60 miles per year to 45 miles per year while continuing the cleaning program regimen beyond Fiscal Year 2005. The Department will continue to work towards the goal of reducing sewer spills from 10.3 to 6.6 spills per 100 miles of sewer line by the end of Fiscal Year 2007.

MWWD expects to experience savings in the areas of salary and fringe benefits, reduced energy costs for MWWD facilities due to new energy producing facilities, the rescheduling of various information technology projects, and data processing savings resulting from an increased accountability of inventory-driven expenditures. The fund is anticipated to be in balance at year-end.

Water

For over 100 years, the Water Department has provided safe and reliable water to the residents and visitors of San Diego in a professional, cost effective, and efficient manner. As a result, the public health, environment, and quality of life are enhanced.

In April 2002 the City Council approved five annual six percent rate increases to support additional CIP financing and operational requirements. The rate increases enabled the sale of additional water revenue bonds totaling \$286.9 million at an historic forty year low for interest rates. Proceeds are being used to fund additional CIP projects as well as refund certain outstanding bonds that were issued in earlier years at higher interest rates. Anticipated CIP expenditures for Fiscal Years 2003 through 2007, including prior year appropriations, are approximately \$511 million. In Fiscal Year 2003, \$102 million of this amount was expended. In Fiscal Year 2004, an additional \$108 million is estimated to be spent. Additional bond issuances are planned within the next four years. It is also anticipated that the continuation of the CIP after Fiscal Year 2007 will require further rate increases and debt financing.

The Water Department's substantial CIP was the result of an extensive strategic planning effort that resulted in a series of capital projects intended to enhance the capability and reliability of the water infrastructure and adhere

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to a Department of Health Services Compliance Order. The multi-year effort includes water treatment plant upgrades, rehabilitating and installing water pipelines, and construction of pump stations and reservoirs. The Water Department has spent approximately \$473 million for these projects from Fiscal Year 1999 through the end of Fiscal Year 2003.

As part of the most recent City Council action to adopt new water rates, the Water Department was directed to implement monthly billing no later than December 31, 2003. The Department successfully implemented this initiative in September 2003. Approximately 97 percent of the City's 263,000 customers were previously billed on a bimonthly basis. It is believed that customers will now find it easier to manage a monthly budget by getting a smaller bill every month, rather than a larger bill every two months.

In August 2002 the City Council authorized the Water Department to proceed with the development and implementation of the Operations Division's Bid to Goal and International Organization of Standards (ISO) 14001 Programs. The Water Department will be the first City agency in the nation to develop both concepts simultaneously. Designed to foster team orientation, improve productivity, decrease expenditures, measure results and assure accountability, the program also incorporates the (ISO) – Environmental Management System. The ISO-Environmental Management System supplements quality improvements by focusing on prevention of pollution, environmental improvements and increasing environmental issue awareness. The Bid to Goal/ ISO 14001 Program will result in an Employee Optimization Bid with an incentive plan and commitment to certain service levels. Currently, the draft Memorandum of Understanding (MOU), Employee Bid, and Business Plan are being reviewed internally. After a comprehensive assessment, these documents will be presented to various internal and external review Committees. Final submission for approval by the City Manager and City Council is anticipated in early 2004.

The Water Department has also initiated development of a Strategic Business Plan to enhance efficiency, effectiveness and accountability in all areas of service delivery. Development of this plan has included analysis of current work practices compared to industry "best practices", input from significant stakeholders, analysis of industry trends, and development of core business goals and objectives and strategies to achieve them. This plan will ultimately provide a means for the Water Department to optimize its work processes and all of its programs and resources around its mission: To provide the San Diego community with safe, reliable, cost effective water and outstanding customer service.

Currently, the Water Department Fiscal Year 2004 budget is consistent with the latest rate case and financial plan. Per ongoing analyses of existing conditions and trends, Department expenditure levels are expected to be within budget appropriations for Fiscal Year 2004. Department revenues are also closely approximating anticipated levels.

Development Services

The Development Services Enterprise Fund is responsible for managing the majority of the construction and development project review services for the City of San Diego. Zoning and development information services are also a part of the Development Services Enterprise Fund. The major functions of building plan check and inspection, development and environmental planning, and subdivision review are centralized to provide greater coordination and management of development.

Total building valuation has decreased from \$2.10 billion in Calendar Year 2002 to a projected \$1.97 billion in Calendar Year 2003, a 6.5% decrease. The total valuation measure is a useful economic, revenue, and workload indicator. Total valuation is the total value of the building construction work for which Development Services building permits are issued, based on industry- recognized valuation standards. Total annual valuation includes all residential and commercial projects.

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The City of San Diego adopted a policy to waive building permit fees for those individuals and families whose dwellings were destroyed in the Cedar Fire and who wish to rebuild their residences. As a result of the adoption of the building permit fee waiver policy, the Development Services Department Enterprise Fund will require reimbursement for expenses incurred with respect to staff time associated with processing of permit requests, plan checks, field inspections, and other associated activities of the building permit process. The cost of the staff time related to the fee waiver in Fiscal Year 2004 is estimated to be \$271,140. It is anticipated that FEMA and OES will reimburse a portion of the total permit requests, permit processing, plan check and inspection costs.

For Fiscal Year 2004 forecasted revenues are expected to be \$58.7 million and will exceed budgeted revenues by \$0.7 million. Fiscal Year 2004 forecasted expenditures are projected to be \$53.2 million, which is \$2.5 million less than budgeted expenditures. The expenditures are projected to be less than budget due to some budgeted vacant positions. The Development Services Department monitors and controls its expenses throughout the fiscal year, and matches expenditures to the annual revenues and reserves available in the Development Services Enterprise Fund.

Refuse Disposal and Recycling

The Environmental Services Department finances several programs from two enterprise funds: the Refuse Disposal Fund and the Recycling Fund. The purpose of the programs is to efficiently and effectively maintain a clean, safe, and healthy environment by reducing, collecting, and disposing of solid waste; implementing and encouraging public participation in recycling programs; preventing litter; managing hazardous materials; and educating the public about the benefits of a safe and sustainable environment.

Under direction of the Mayor and City Council, the Department has completed a multiyear program to expand the collection of commingled recyclable commodities to all residences receiving City-provided trash collection. Citywide expansion of separated greenery collection will continue as funds are available. Remapping of collection routes to improve operational efficiency is currently in the planning stages and slated for implementation later this fiscal year.

The Environmental Services Department Enterprise Funds are providing waivers or reimbursements of Miramar Landfill disposal fees for Firestorm 2003 tonnage and reimbursement for costs of recycling concrete and brick tonnage at local designated facilities to directly impacted property owners within the City, per City Council direction. With full reimbursement related to this action anticipated, the Enterprise Funds are projected to end the fiscal year with operating costs below budgeted levels and within funds available.

Golf Course

The Golf Course Enterprise Fund is used to manage and maintain the Torrey Pines and Balboa Park Golf Courses, as well as the Mission Bay Golf Course effective November 8, 2003. This Non-General Fund is financed solely from golf green fees, concessions, driving range fees and interest on revenue derived from those courses. During Fiscal Year 2004, in July, staff hosted the Junior World Golf Championship, the largest and most prestigious junior golf event in the world. In February 2004, Golf Operations will host the very exciting and highly publicized Buick Invitational PGA TOUR, played by many top golf professionals. As in past years, staff at Torrey Pines Golf Course received high accolades for course playing conditions and staff support. Staff will also conduct the Men's and Women's City Amateur Golf Championship in June 2004.

For Fiscal Year 2004, due to the success of the Fiscal Year 2002 City Council approved operational changes for Torrey Pines and Balboa Park Golf Courses, golf revenues continue to increase. The operational changes include higher non-resident rates, new county 18-hole rates at Torrey Pines Golf Course, and non-resident credit card guarantee. It is projected that this fund will be in balance at year-end.

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City Airport

The City Airport Enterprise Fund continues to be the major source of funding for developing and maintaining Montgomery Field and Brown Field Airports. Fiscal Year 2004 has been a year of significant progress in reaching the financial and airport development goals of the City.

The Airport Improvement Program (AIP), which will provide electrical upgrades to the runway and taxiway lighting/electrical systems at Montgomery Field, is 85 percent complete.

The final phase of the installation of a perimeter fence at Montgomery Field is near completion, which will result in a significant reduction of runway incursions and further enhancement of the Post-9/11 Airport Security Program.

The building demolition project at Brown Field Airport has been completed and a business plan to improve and renovate the airport is being implemented.

Expenditure projections indicate that both airports are operating within budget, and the revenues are trending as expected with no major variations.

Utility Underground Program

It is estimated that approximately 1,000 miles of overhead utilities exist in the City of San Diego. As of Calendar Year 2002, the City of San Diego Underground Program was converting overhead lines to underground at a pace of \$10 million per year. This level of funding allowed approximately 10 to 12 miles of overhead lines to be buried per year along major roads and thoroughfares.

In December 2002, the California Public Utilities Commission (CPUC) approved a 3.53% surcharge on electricity for City of San Diego residents, for the sole purpose of expanding the undergrounding of overhead electric lines. This surcharge is expected to generate approximately \$38 million per year. This is expected to increase the undergrounding of lines to about 41 miles per year.

Collection of this surcharge began in January 2003 with the City receiving its first payment in May 2003. In July, the first project funded with this surcharge began construction. For Calendar Year 2003, SDG&E completed six conversion projects and currently has 20 projects in construction. Total expenditures for undergrounding in Calendar Year 2003 are expected to be about \$23 million. In Calendar Year 2004, the City's Underground Conversion Program expects to begin an additional 37 projects and to expend approximately \$55 million for underground conversions.

The current list of projects which have been expedited due to this increased funding includes projects that will underground lines adjacent to more than 62 schools and more than 40 parks, recreation centers, libraries, hospitals, trolley stations, and post offices. At this increased level of undergrounding it is estimated that not only could all of these projects be completed in the next five to seven years, but that the complete undergrounding of the remaining 150 miles of major and residential collector streets within the City of San Diego could also be completed in that time frame.

Under current CPUC undergrounding rules, undergrounding of residential streets is all but prohibited. Under the City of San Diego Underground program, however, the CPUC has granted a deviation from CPUC underground rules for the City that will allow the undergrounding of residential streets. Thus, the City will now be able to begin converting the 800 miles of residential streets that have had overhead lines for decades. A program has been devised and approved by Council that will allow conversions to happen in whole

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communities, with residential projects envisioned that will encompass large multi-block areas and not just single streets. It is anticipated that the completion of all residential areas within the City of San Diego could be completed in approximately 20 to 25 years.

The City's Underground Conversion Program no longer looks at how much undergrounding can be done on a year by year basis, but as an overall plan as to how to complete the undergrounding of the entire City. In this regard, a Prioritized Master Plan that lists all streets to be converted within the City was approved by the City Council on November 17, 2003 and is to be revised each year not later than June 30th. City staff is required to report twice yearly to the City Council and the CPUC the status of the fund as well as that of all underground projects which have been funded.

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APPENDIX C - Special Revenue Fund Status

Balboa Park/Mission Bay Park Deferred Maintenance Fund

The Balboa Park/Mission Bay Park Deferred Maintenance Fund was established using one-time monies to fund deferred maintenance projects in Balboa Park and Mission Bay Park. At this time the projects are almost all completed and the fund is projected to be in balance at year-end.

Centre City Maintenance Fund

The Centre City Maintenance Fund is used to identify maintenance problems, develop solutions, and coordinate services and projects for the benefit of downtown. Staff serves as a liaison between City departments and businesses regarding resolution of maintenance issues. In addition to general maintenance and hand sweeping, approximately 60% of this fund is used to provide contractual services for weekend refuse collection, 24-hour-a-day downtown restroom availability, and Horton Plaza Theatres maintenance. Revenues and expenditures are projected to be in balance at year-end.

Convention Center Complex and New Convention Facility

The Convention Center Complex Fund reflects the transfer of funds from Special Promotional Programs for the purpose of planning, promoting, operating, and maintaining the San Diego Convention Center, and also providing for the expansion of the Convention Center. This Fund is projected to be in balance at year-end.

The New Convention Facility Fund provides funding for the operation and maintenance of the Convention Center. In addition, it provides City services related to operational and developmental activities between the City, the Convention Center Corporation, and the San Diego Unified Port District. It is projected that this Fund will be in balance at year-end.

Emergency Medical Services

Emergency Medical Services (EMS) provides 24-hour medical transportation services to the City of San Diego through San Diego Medical Services Enterprise, a public-private partnership between the City of San Diego and Rural/Metro Corporation. Ambulances are staffed by personnel from San Diego Fire-Rescue Department and Rural/Metro of San Diego.

It is expected that EMS expenditures will be recovered in total by the distribution of revenues and reimbursement from San Diego Medical Services Enterprise, Rural/Metro of San Diego, San Diego Fire-Rescue Department, and the City's General Fund budgets.

Energy Conservation and Management Program

The Energy Conservation and Management Program completed a conversion from manual energy billing to an automated paperless system. This conversion to Electronic Data Interchange (EDI) resulted in saving 960 labor hours allowing a shift of focus to billing analysis which has identified \$450,000 of annual savings for the Metropolitan Wastewater Department. Despite the increase of 40,000 sq. ft. of new City facilities in Calendar Year 2003, energy consumption was 17,600,000 kilowatt hours lower than the base year 2000. Energy Division's pursuit of energy independence was demonstrated in the retrofit of Police Department Headquarters. The project will save \$600,000 annually by avoiding the purchase of 4,000,000 kilowatt hours per year. This facility will also be able to operate independent of the electrical grid during emergency situations with the new cogeneration and photovoltaic power generation systems. The City joined forces with the cities of Carlsbad, Chula Vista, Escondido, and Oceanside, as well as San Diego Regional Energy Office and the County of San Diego to form a San Diego Regional Energy Partnership. This partnership received authorization to administer over \$10 million of energy efficiency programs funded by the California Public Utilities Commission. It is projected that this fund will be in balance at year-end.

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Environmental Growth

The Environmental Growth Fund is used exclusively for the purpose of preserving and enhancing the environment of the City of San Diego. This fund is financed from franchise revenues. One-third of the money funds maintenance costs for regional parks including Balboa Park, Mission Trails Regional Park, Tecolote Canyon Natural Park, Black Mountain Park, San Pasqual Open Space and Los Peñasquitos Park. Two-thirds of the monies received are used exclusively to pay the debt service for bonds issued for the acquisition, improvement and maintenance of open space to be used for park or recreational purposes. Revenues are anticipated to be in line with the budgeted amounts for the current fiscal year.

Facilities Financing

Facilities Financing, a section of the Planning Department, is the implementation arm of Community Planning. Public Facilities Financing Plans identify community plan facilities and provide cost estimates. In conjunction with Community Planning, existing and build-out development projections are determined. From this determination, fees for each community are calculated based on the type and size of future development/redevelopment.

Facilities Benefit Assessments (FBA) or Development Impact Fees (DIF) are determined and charged for development in all planned urbanizing and urbanized communities within the City of San Diego. A developer usually pays one or the other (FBA or DIF), but not both. As development occurs, plan files are reviewed and fees assessed. Fees are collected from development when building permits are issued. The money is used by the City to provide needed public facilities such as streets, libraries, parks and fire stations. Key accomplishments are the number of community facilities provided all or in part with these fees. Facilities Financing also assesses Housing Trust Fund Fees (HTF). These fees were adopted by Ordinance O-17454 on April 16, 1990. This fee is applicable on new construction, additions or interior remodeling to accommodate a change from the structure's current use. These fees are only applicable to non-residential development and were established to meet, in part, the affordable housing needs of San Diegans.

Development Agreements, Tentative Maps, and Cost Reimbursement Districts are monitored to ensure that conditions are met on a timely basis and that funds collected are used for the purpose intended. Facilities Financing is responsible for portions of the Strategic Framework Element regarding financing strategy and city-wide inventory.

This year, expenditures are programmed to occur consistent with the budget.

Gas Tax

The Gas Tax Fund is a result of a combination of laws that tax the use of gasoline. The current total tax on fuel is \$0.18 per gallon. The City of San Diego's share of Gas Tax revenue is based on a formula using vehicle registration, assessed valuation and population. The funding generated is used to perform citywide repairs and restoration to existing roadways, reduce congestion, improve safety and provide for the construction of needed facilities within the public rights-of-way.

In addition, this fund provides landscape maintenance for selected center medians and rights-of-way, traffic engineering and street maintenance services.

In Fiscal Year 2004, the Mayor and City Council approved \$23.5 million in operating programs to be funded with Gas Tax funds. Based on the most recent estimates, the Gas Tax Fund will be in balance at year-end.

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Information Technology and Communications

The Information Technology (IT) Division establishes strategies, policies and procedures for effective implementation of citywide information technologies. In doing so, the IT Division manages the day-to-day operating agreement and negotiates user rates with San Diego Data Processing Corporation (SDDPC) on behalf of the City Manager. The Division is also responsible for the Cable TV Program, the City's E-Government Program, including the City's Web Site, the Geographic Information System (GIS) Program, IT Project Management, including operational IT standards and practices, citywide IT budgeting, management of citywide IT contracts, and special projects such as the Employee Computer Purchase Program.

The IT Division is funded through the Information Technology and Communications Fund. Because the IT Division represents and provides services to all City departments, this Special Revenue Fund is paid for by all City departments. Approximately 32 percent of the cost for this fund is apportioned to the General Fund and 68 percent of the cost is covered by the Non-General Funds.

The Communications Division provides effective wireless communications to the City and other governmental agencies, engineering, installing, maintaining and repairing wireless communications systems. The Division is funded through the Information Technology and Communications Fund, with costs allocated citywide. The Communications Division is also forecasting full expenditure of the Fiscal Year 2004 Budget.

Los Peñasquitos Canyon Preserve

The Los Peñasquitos Canyon Preserve Park Fund provides for the protection and enhancement of the natural features of Peñasquitos Canyon Preserve while providing for passive recreation in accordance with the Peñasquitos Master Plan. Sources of revenue for this fund include interest income from the endowment fund established as a result of the American-General land trade agreement, concession leases, and a transfer from the Environmental Growth Fund. Revenues and expenditures are projected to be in balance at year-end.

Optimization Program

The Optimization Program assists City business units to ensure that public services are provided to the citizens of San Diego in a productive and optimal manner. This is done through the process of re-engineering projects and departmental assessments. Since the program's inception, 21 re-engineering projects have been successfully completed resulting in \$139 million in savings through cost avoidance and/or increased revenue. The program includes the administration of the Citywide Resident Satisfaction Survey, as well as the ongoing performance monitoring of City services that have undergone the competitive assessment process. It is projected that the Optimization Program will be in balance at year-end.

Police Decentralization

This program funds the site acquisition, planning, and construction of new, permanent police facilities; annual debt payment for permanent facilities; and payment for jail services per a negotiated contract with the County of San Diego. Currently, the Police Decentralization Fund is not projected to be in balance at year-end. However, plans to mitigate the projected deficit are being developed.

Public Art

The Public Art Fund supports programs and services that advance the development of public art projects in San Diego and advocate the inclusion of artists in public and private development. It supports the management and maintenance of the City's art collection as well as the planning and administrative costs associated with the Public Art Program and implementation of a Public Art Master Plan in Fiscal Year 2004. The Public Art Fund is projected to be in balance at year-end.

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QUALCOMM Stadium

QUALCOMM Stadium has a long and proud history of providing a venue for world-class sporting and entertainment events. In addition to being the home of the Chargers, Aztecs and Holiday Bowl, the Stadium has hosted three Super Bowls, two World Series, and one All-Star Game. Other major events over the years have been concerts, international soccer matches and conventions.

The Stadium projects the year-end fund balance to be at budget this year. For the 2003 Chargers season, the amount owed for the ticket guarantee is approximately \$5 million, \$1 million less than the \$6 million budget. The net revenue is almost \$1.6 million and could increase to over \$2.2 million if the City's \$700,000 claim for the cancelled game due to the fire is paid. Attempts are being made to recover the lost revenue through insurance claims. If successful, revenues should exceed budgeted estimates for the year.

With the close of the 2003 Baseball Season, the Stadium has lost the San Diego Padres as a major tenant. By early January 2004, the full-time Stadium staff will be reduced from 50 to 19.5. A large number of employees have already been placed in other City positions.

After a nationwide search the Stadium's new Marketing Manager has been hired and is working with the Stadium Advisory Board on developing a marketing plan for filling the available dates and replacing that lost revenue stream. Efforts are already underway to secure a Major League Soccer Team for the Stadium. Recent Council approval of exclusive agreements to conduct events in the parking lot (car and RV sales and home shows) will increase revenues by \$270,000 annually during the terms of the agreements.

Seized and Forfeited Assets

This program provides for the expenditure of proceeds from seized and forfeited assets. Under the Federal Comprehensive Crime Control Act of 1984, local law enforcement agencies may receive from the federal government seized and forfeited assets from operations in which the local agencies participated. The large number of narcotics investigations conducted by the Police Department, in conjunction with federal authorities, makes the Department eligible for participation in the program. Federal law requires that assets received go toward enhanced enforcement activity and not be used to supplant normal City revenues. Assets have been used to support the Air Support Program, the STAR/PAL Program, and the Juvenile Services Program. The Seized and Forfeited Assets Fund is projected to be in balance at year-end.

Solid Waste Local Enforcement Agency

Development Services' Solid Waste Local Enforcement Agency (LEA) is certified by the California Integrated Waste Management Board (CIWMB) to enforce state solid waste laws and regulations. To fulfill this mandate, the LEA carries out a comprehensive permitting and inspection program for all active solid waste facilities and operations within the City's jurisdiction. The LEA is also responsible for enforcing state requirements at closed, inactive, or abandoned disposal sites to ensure the protection of public health and safety and the environment. The fund is projected to be in balance at year-end.

Special Districts Administration

The purpose of Special Districts Administration is to provide a cost-effective method for the City to facilitate provision of necessary public improvements in developing areas of the City. Special Districts Administration handles all aspects of the land secured debt issuance process, including district formation, bond issuance, and administration of special assessment districts and community facilities districts.

The overall budget for the Special Districts Administration is in good standing. It is anticipated that all expenses for Special Districts Administration will be reimbursed by revenue received by the end of Fiscal Year 2004.

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Special Promotional Programs

The purpose of this fund is to advance the City's economic health by supporting programs that increase hotel occupancy and attract industry, resulting in the generation of Transient Occupancy Tax (TOT) and other revenue; to develop, enhance, and maintain visitor-related facilities; and to support the City's cultural amenities and natural attractions. Due to recovering growth in TOT revenue, revenue to Special Promotional Programs is expected to be essentially on budget and this fund will be in balance at year-end.

Storm Drain

Storm Drain fees were implemented by the City of San Diego in 1990 and are collected as part of all water and sewer utility bills. The revenue collected is expended for operation and maintenance of storm drains, construction of capital projects and the general management of the storm drain system, including monitoring the system for silt, toxic material and related pollutants. The current fee is \$0.95 cents per single-family residence meter per month and \$0.06 cents per hundred cubic feet, per month, for all other meters.

The Storm Drain Fund, which is comprised of Storm Drain fees, is budgeted at \$6.0 million in Fiscal Year 2004. These funds are allocated in the current year budget for a wide range of activities related to construction and maintenance of storm drains as well as storm water management programs. The Storm Drain Fund will be in balance at year-end.

Transportation/Street Division

As a result of state budget reductions, the City of San Diego did not receive anticipated revenue of approximately \$2.6 million in the current fiscal year from AB2928, the Traffic Congestion Relief Act. In order to accommodate the proposed decrease in revenue and to contribute funding for emergency services related to the Cedar Fire, there will be a reduction in funds available for the street resurfacing, slurry seal and sidewalk programs.

TransNet

On November 7, 1987, voters in the County of San Diego approved the San Diego Transportation Improvement Program (TransNet), which allowed for a half-cent increase in the local sales tax (Proposition A). The term of this program is for 20 years, ending in 2008. The City of San Diego's share of TransNet revenue is based on population and the number of local street and road miles maintained. The funds generated are used to perform citywide transportation improvements such as the repair and restoration of existing roadways and construction of needed facilities within the public rights-of-way. Through a cooperative effort with the San Diego Association of Governments (SANDAG), the City of San Diego is able to manage the fund so that the most pressing transportation problems are solved.

More specifically, TransNet revenue is allocated for traffic engineering and street maintenance services, graffiti control activities, transportation and drainage, telework services, traffic studies plans, and other TransNet eligible capital improvement projects.

In Fiscal Year 2004, the Mayor and City Council approved \$29.1 million in operating programs and capital improvement projects to be funded with TransNet funds. In Fiscal Year 2004, the Mayor and City Council also approved a TransNet Commercial Paper budget of \$29.3 million. Commercial Paper is a borrowing tool typically used to raise cash needed to cover current cash flow deficits and is generally viewed as a lower cost alternative to bank loans. SANDAG issues Commercial Paper on behalf of the City as advanced funding of TransNet monies projected to be received in the future. For Fiscal Year 2004, it is projected that \$7.0 million of TransNet Commercial Paper will be issued.

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Unlicensed Driver Vehicle Impound

This program provides for specialized enforcement of state of California laws regarding the operation of a motor vehicle without a driver's license or with a suspended or revoked driver's license. The program was initiated with grant funding from the state of California Office of Traffic Safety and continues as a self-supported program funded by the fees imposed on the impound of vehicles of unlicensed drivers. It is anticipated that the fund will be in balance at year-end.

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APPENDIX D - Internal Service Fund Status

Central Stores

The Central Stores Revolving Fund is responsible for the procurement, storage and distribution of approximately \$27.5 million in consumable materials and supplies to City departments, the administration of the Citywide Open Purchase Order Program, the redistribution and sale of surplus City property, the interoffice and United States Postal Service Mail Center operation and the City Public Works Emergency Communication and Dispatch Center (Station 38). The Surplus Property Program has realized \$1,172,000 in revenue to date. The customer satisfaction rate for the Storeroom Operations activity is currently 95%. Revenues and expenditures are projected to be in balance at fiscal year end.

Engineering and Capital Projects – Water and Wastewater Internal Service Fund

The Engineering and Capital Projects Department's Water and Sewer Design and Field Engineering-Water/Wastewater Divisions are funded through the Water and Metropolitan Wastewater Department. The purposes of these Divisions are to provide preliminary engineering, the design of water and wastewater projects, and construction inspection services.

As of December 2003, the Division has 149 active water projects totaling \$151.5 million and 316 active wastewater projects totaling \$836.1 million.

An example of one major project in progress is Sewer Pump Station 30A. Construction of this project is anticipated to be completed by Vadnais Corporation by June 2004. Revegetation maintenance and monitoring will be completed in 2006 for a total construction cost of 9.5 million. This pump station is located near La Jolla Village Drive and Interstate 5 in the University City community. The project includes the abandonment of the pump station and replacement with gravity mains. It is needed due to deterioration of the pump station, lack of backup and inadequate access for maintenance.

Much of the project is being built utilizing tunneling methods. The mains range from 6-18 inches in diameter. Some sections are very deep and the alignment also crosses I-5 and UCSD, as well as other properties. Property acquisition for this project is a challenge and condemnation is still in progress.

The Division will also be developing a number of small construction utility replacement projects at a construction cost of \$500,000 or less each to encourage participation from contractors that typically do not work with the City of San Diego.

Another project that started construction in June of 2003 is the replacement of Sewer Pump Stations (SPS) 28, 29 and 45 with one larger and a more modern pump station that will be known as SPS # 45. To eliminate SPS 28 and 29 the flow will be diverted from these stations via 5,226 feet of 24" gravity main to SPS # 45. Most of this main is located approximately 20 feet under the Torrey Pines Golf Course and will be micro-tunneled to avoid disruption to the course and its patrons. From SPS 45 it will take the flow for a little over a mile via a 10" force main which then empties to an 18" sewer main for approximately three quarters of a mile which then discharges to the existing gravity main on Gilman Drive. This construction will take almost two years to complete.

The expenditures for the Division are in alignment with this year's budget and project schedules.

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Equipment Division

The Equipment Division of the General Services Department is responsible for the acquisition, maintenance/repair, and disposal of the City's non-public safety fleet.

The Equipment Replacement Fund acquisition plan for the year calls for \$5.2 million (39 vehicles) in General Fund lease purchases, \$1.3 million in Street Division cash purchases (17 vehicles), and \$4.1 million in cash purchases (87 vehicles) for other Non-General Fund departments.

Equipment Division is also purchasing the following fleet additions: Street Division, 11 pieces of equipment for \$758,000; and other Non-General Fund departments, 5 pieces of equipment for \$156,000.

The combined Operating and Replacement Funds are projected to be in balance at the end of Fiscal Year 2004.

Publishing Services

The Publishing Services Revolving Fund is responsible for managing, supervising and producing the City's publications, graphics, multimedia and convenience photocopier requirements in an efficient and organized manner to achieve the highest quality at the lowest possible cost. Over 5,000 printing, graphics, multimedia and photocopy requests have been completed thus far in the fiscal year with a 94 percent satisfaction rate. Publishing Services has developed a new General Services/Publishing Services/Central Stores/Station 38 Intranet Home Page which will be designed for customers to submit orders on-line, answer frequently asked questions and provide general information. Publishing Services is submitting accounting for Print Requisitions and Copier Service Requests via a computerized chargeback system through the Auditor's Department.

It is projected that the Publishing Services Revolving Fund will be in balance at year-end.

Risk Management

Risk Management oversees the appropriations designated for the effective prevention, reduction or elimination of the City's risk by centralizing the administration of safety, employee benefits, Workers' Compensation and public liability exposure programs. Having these types of programs in place serves as an incentive for employee recruitment, retention and satisfaction, while protecting the City's assets, employees, and citizens.

Although the City allocated additional resources in Fiscal Year 2004 to address the cost of rising Workers' Compensation costs, several major claims in the current year are expected to increase expenditures over budgeted amounts. The Workers' Compensation expenditures are projected to be \$2.8 million higher than last year and \$800,000 higher than budgeted. Workers' Compensation costs have risen significantly from \$13.7 million in Fiscal Year 1998 to \$25.2 million in Fiscal Year 2003, an increase of \$11.5 million in over five years.

A \$7.1 million increase in medical costs over a five-year period (1998-2003), given that the incident rate and the number of claims filed annually have remained relatively flat, highlights that medical costs have increased at an alarming pace. In this case, medical costs have risen in excess of 104 percent since 1998. As medical costs make up the single largest cost-driving factor of Workers' Compensation costs, this trend provides a strong stimulus for the implementation of safety measures currently being undertaken by the City and for the continued effort by the City to promote Workers' Compensation reform.

The reasons for the rapid Workers' Compensation cost inflation experienced by the City are very complex. According to the California Workers' Compensation Institute (CWCI), the 1993 Workers' Compensation legislative reform has led to unintended consequences. Their study of the legislation concludes that it has resulted in an escalation of litigation, claim duration and medical costs. Additionally in 2002 Governor Davis

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signed a Workers' Compensation bill that allowed for a gradual substantial increase in employee disability benefits for 2002 through 2006.

In 2003 Governor Davis signed Workers' Compensation reform legislation designed to reduce medical and vocational rehabilitation expenditures. The new legislation, which applies to injuries occurring on or after January 1, 2004, will provide some savings for injuries occurring in 2004. The savings brought about by this legislation coupled with the increases in indemnity benefits introduced in the 2002 legislation makes it difficult to identify a savings factor for the purposes of estimating 2004 Workers' Compensation expenditures.

Governor Schwarzenegger has asked the state Legislature, in his state of the state address, to prepare an additional Workers' Compensation reform package by March 1, 2004. If the package does not provide significant reform the Governor has threatened to place a Workers' Compensation reform package on the November 2004 ballot. Until any reform package is approved the impact of Workers' Compensation legislature on the City remains uncertain.

It is projected that Risk Management will be in balance at year-end once the Workers' Compensation costs are accommodated in the General and Non-General Funds.

Special Training

The Special Training Program consists of three main components: Citywide Training, Career Development, and City Manager's Equal Employment Opportunity Program. Citywide Training offers training classes and courses to employees across all levels of the organization and results in increased knowledge of best practices in management and supervision. Training programs include Academy 2000, Dimensions in Discipline, and Inspiring Performance Through Rewards and Recognition.

The Career Development Program enables City employees to successfully manage and develop their careers through customized programs such as: the Career Management Program, the Modified Career Management Program, the Administrative Support Mentoring Program, the Field Career Development and Mentoring Program, the Fire Academy Mentor Program, and the Municipal Government Fellowship Program. Skill based trainings are also offered that focus on interviewing, presenting, communicating, and networking.

The City Manager's Equal Employment Opportunity Program provides coordination between representatives from the City Attorney's Office, Equal Employment Investigations Office (EEIO) and several operating departments, as well as City department managers, to create citywide EEO complaint, reporting, tracking and resolution procedures, including the development of EEO process and protocol across departments.

Due to budget constraints, the number of trainings and services Special Training provides has been significantly reduced in Fiscal Year 2004. It is projected that the Special Training Program will be in balance at year-end.